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IN THE

Supreme Court of the United States

October Term, 1978

No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,
Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

HOWARD I. FRIEDMAN,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorney for Petitioner.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
THOMAS W. HENNING, Esq., and
LOEB AND LOEB,

and

ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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SEARS, ROEBUCK AND CO., a corporation,
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vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

Petitioner, Sears, Roebuck and Co., a corporation, respectfully prays that a writ of certiorari issue to the Court of Appeal of the State of California, Second Appellate District, to review that Court's decision holding that California Revenue and Taxation Code Section 225, providing for an exemption from property taxation of imported goods brought into the state for shipment outside the state, is invalid on the grounds that such an exemption constitutes a regulation of foreign commerce in contravention of the United States Constitution. The Supreme Court of California denied a petition for hearing in said court.*

*The petition for certiorari is properly directed to the Court of Appeal where that court's decision is denied review by the California Supreme Court [See *Hammerstein v. Superior Court*, 341 U.S. 491, 492 (1951).]

Opinion Below.

The opinion of the Court of Appeal is reported below at 85 Cal.App.3d 763, and is set forth in Appendix A, hereto.

Jurisdiction.

The decision of the Court of Appeal to be reviewed was entered on October 25, 1978. A petition for hearing in the Supreme Court of California was denied on January 17, 1979 with three Justices voting in favor of granting a hearing.

The jurisdiction of this Court is invoked under 28 United States Code, Section 1257(3).

This Court's review by certiorari is sought on the grounds that the Court of Appeal has determined novel and substantial questions arising under the United States Constitution involving the application of this Court's decision in *Michelin Tire Corporation v. Wages,* 423 U.S. 276 (1976), to one of California's tax laws, and has decided them in a manner the petitioner believes to be erroneous.

Questions Presented.

1. Did a state statute, valid when enacted, which confirmed the immunity of certain imported goods from state property taxation under the original package doctrine of *Low v. Austin,* 80 U.S. (13 Wall.) 29 (1872), become unconstitutional as a regulation of foreign commerce immediately following this Court's decision in *Michelin* overruling *Low v. Austin?*

2. Unlike the situation which existed prior to *Michelin,* must state taxing statutes subsequent to *Michelin* treat foreign commerce and interstate commerce with meticulous equality?

3. Is it sufficient to invalidate a state statute exempting certain imported goods from property taxation simply to point out that a comparable exemption was not accorded goods brought into the state from other states without any showing as to the extent of actual discrimination against interstate commerce, if any?

Constitutional Provisions and Statutes Involved.

1. Article I, Section 8, Clause 3 of the United States Constitution.

2. California Revenue and Taxation Code Section 225 printed in Appendix B hereto.

Statement of the Case.

Petitioner operates numerous retail stores in California and other states. All of the goods involved herein were purchased in foreign countries, imported into California, and held in warehouses in California on the state's tax date, March 1, 1976, awaiting shipment to petitioner's stores in other states. All such goods were in their original packages and would have been immune from state taxation under the original package doctrine of *Low v. Austin,* if that case had not been overruled by *Michelin,* decided in January, 1976.

In 1972, in *Volkswagen Pacific, Inc. v. City of Los Angeles,* 7 Cal.3d 48 (1972), the California Supreme Court held that goods which were imported by a wholesaler in sea vans and removed from the sea vans for sale and delivery to dealers were not immune from a city license tax. Many county assessors in California erroneously interpreted the *Volkswagen* case as holding that all goods imported in sea vans lost their immunity from state taxation upon the opening of the vans. The resulting assessments caused wide-

spread consternation among California importers many of whom commenced diverting their imports from California ports to ports in other states such as Oregon and Washington which had previously enacted "free port" laws. Some 37 states have such laws.

In an effort to prevent the diversion of imports from California to other states having "free port" laws, the California legislature enacted California Revenue and Taxation Code Section 225, which is California's version of a Free Port law. Insofar as relevant, it provides that goods produced outside the United States and brought into California for shipment and sale outside the state are exempt from property taxation. The section was enacted in 1975 and became effective January 1, 1976. Both the date of enactment and the effective date preceded this Court's decision in *Michelin*.

The tax status of goods other than the imports described in the preceding paragraph was not affected by Section 225. Thus goods imported for sale or use in California were, at the time the section was enacted, either immune or taxable depending upon whether or not they met the requirements of the original package doctrine. Goods produced in the state and still in the state on its tax date remained fully taxable. Similarly, goods brought into the state from other states and in the state on the tax date remained fully taxable regardless of whether brought in for sale or use in, or for shipment and sale outside, the state.

The *Michelin* case which overruled *Low v. Austin,* thereby terminating the original package doctrine, was decided in January 1976. The state thus obtained jurisdiction for the first time in 105 years to tax

imported goods as fully as it could tax goods produced locally or brought in from other states. Goods imported for sale and delivery in California thus became taxable. However, Section 225 continued to provide an exemption for goods imported into the state and held here temporarily for subsequent shipment and sale outside the state. A similar exemption was not accorded to goods brought into the state from other states and held here temporarily for subsequent shipment and sale outside the state.

Notwithstanding the enactment of Section 225, the Assessor of Los Angeles County, unlike the assessors of other California counties, continued to assess goods imported in and removed from sea vans. A substantial quantity of petitioner's goods which had been so imported and removed from sea vans, and which were in warehouses on March 1, 1976, awaiting shipment to other states, were so assessed. Petitioner paid the taxes assessed and after exhausting its administrative remedies, instituted suit for recovery.

Initially the respondents argued that Section 225 was intended to exempt only imported goods actually in transit out of the state and that it did not apply to imported goods held in warehouses even though there only temporarily awaiting shipment to retail outlets in other states. This contention was rejected by both the Los Angeles Superior Court and later by the California Court of Appeal.

In the trial court and in their appeal to the Court of Appeal, Second Appellate District, respondents raised the point that Section 225 constituted a regulation of foreign commerce forbidden by the Commerce Clause of the United States Constitution. This contention was

rejected by the trial court. Respondents cited a number of cases in support of its contention but relied principally on this Court's decision in *Boston Stock Exchange v. State Tax Commissioner,* 429 U.S. 318. The Court of Appeal upheld this contention and further held Section 225 invalid in that the exemption provided therein would interfere with and frustrate Congressional power to impose tariffs on imports.

Petitioner believes that the *Boston Stock Exchange* case is clearly distinguishable and for other reasons discussed herein believes Section 225 does not offend the United States Constitution.

STATEMENT OF REASONS FOR GRANTING THE WRIT OF CERTIORARI.

The application of state and local tax laws to imported goods has long been a subject of controversy. It has spawned an enormous amount of litigation, and the decisions have been far from uniform. Numerous fine lines of distinction have frequently been drawn. The subject has been in a state of great confusion.

The decision of this Court in *Michelin,* repudiating the original package doctrine of *Brown v. Maryland,* 25 U.S. (12 Wheat.) 262 (1827) and *Low v. Austin,* has clarified the situation enormously. There are, however, a number of important problems remaining. The instant case affords an opportunity to resolve some of these.

Although it is clear that a state may, for years subsequent to *Michelin,* tax imported goods which were previously immune, must it do so? Or, may a state in order to prevent the diversion of its import business to other states, such as Oregon and Washington which have enacted free port laws, continue to exempt goods which previously were immune from state taxation for over 100 years without at the same time revising its laws to exempt goods moving in interstate commerce which were historically taxable even while the immunity of imported goods existed?

Even if it should be held that state tax laws must hereafter deal equally with foreign and interstate commerce, should not a period of grace be allowed the states in which to revise their laws in the light of *Michelin* and the *Boston Stock Exchange* case? In this connection it is pertinent to note that the *Boston Stock Exchange* case was not decided until 1977, where-

as the instant case concerns the validity of a statute enacted in 1975, prior to *Michelin*, in the determination of a tax liability for the year 1976. It is significant to note that the taxes involved were not assessed on the theory that Section 225 constituted an invalid regulation of foreign commerce, and were defended on that ground for the first time in 1978.

The rule urged by respondents and upheld by the court below that after *Michelin* state taxing statutes must treat foreign commerce and interstate commerce with meticulous equality is contrary to the philosophy of *Allied Stores of Ohio v. Bowers,* 358 U.S. 522 (1959), which held that a state may tax the goods of nonresidents more favorably than the goods of residents. The adoption of a rule requiring hard and fast equality would give rise to serious questions as to the validity of a great many state taxing policies some of which will be referred to below.

Respondents have made no effort whatsoever to establish that Section 225 results in actual discrimination against interstate commerce. It may well be that goods brought into the state from other states for shipment and sale outside the state are seldom, if ever, assessed for property taxation in California. Certainly there is nothing in the record to support a contrary conclusion. For this reason alone the decision of the court below should be reversed. It strikes down a state taxing statute solely on a *per se* basis contrary to recent pronouncements of this court concerning the extent to which interference with commerce is required before the Commerce Clause invalidates state tax provisions.

I.

The Statute Involved Does Not Result in an Invalid Regulation of Foreign Commerce.

It is important to note that the statute in question was enacted in 1975 at a time when imported goods of the kind involved herein were immune from state taxation. The statute was enacted to prevent local county assessors from continuing to assess imported goods as a result of their erroneous interpretation of the *Volkswagen* case. Such assessments were driving import business out of the state to other states with free port laws. At the time, and for over 100 years prior thereto, it was permissible for a state to tax goods coming into the state in interstate commerce notwithstanding that goods imported from foreign countries were immune from such taxation. Thus the statute was entirely valid at the time of its enactment.

A statement of this Court in its opinion in *First Federal Savings and Loan Association v. State Tax Commission, et al.,* 437 U.S. 255 (1978), is pertinent here. That case involved the validity of a state statute which allowed federal and state savings and loan associations a deduction for additions to reserves in computing the amount of a state excise tax. At the time the statute was adopted the reserve requirements of the two classes of associations were equal. Later, however, the reserve requirements applicable to federal savings and loan associations were reduced. As a result such associations received lesser deductions than state associations and consequently were required to pay larger state taxes. The federal associations contended that the state statute was invalid on the grounds that the state tax discriminated against federal savings and loan associations. The Court upheld the tax and in the course of its opinion said (pp. 259-260):

> "Any suggestion of discriminatory purpose is foreclosed by the fact that the tax was enacted when federal reserve requirements were as high as state requirements."

A similar observation is appropriate here. The legislature in enacting the statute involved was not displaying an unfriendly discriminatory attitude toward interstate commerce, but was simply following a pattern which had existed from time immemorial. Even after the decision of this Court in *Michelin* the apparent discrimination against interstate commerce was not due to any deliberate attempt or unfriendly attitude on the part of the California Legislature, but rather was due to the passive continuation of the *status quo ante* with respect to goods brought in from other states.

The respondents and the court below both relied heavily on the *Boston Stock Exchange* case to support the conclusion that the statute constituted an invalid regulation of foreign commerce. The *Boston Stock Exchange* case, however, is clearly distinguishable.

There the New York Legislature adopted a statute imposing one rate of tax on transfers of securities in New York where the sale took place outside New York, and another and lower rate of tax on transfers in New York where the sale took place in New York. The obvious purpose of the statute was to encourage sales to be consummated on the New York Stock Exchange rather than on Exchanges in other states such as the New Jersey Stock Exchange. Thus discrimination in favor of local transactions as against interstate transactions was the method or tool employed to benefit local business at the expense of business in other states. Any such purpose is completely absent in the instant case.

The Legislature's sole concern in enacting Section 225 was to prevent the threat of local taxation of goods imported into California and held here for shipment and sale outside the state from driving import business to other states where the threat of such taxation did not exist. There was no intent, as in the *Boston Stock Exchange* case, to benefit one form of commerce at the expense of another. Insofar as effecting the legislative objective is concerned, *i.e.,* the prevention of flight to other states of import business, it was utterly immaterial what the legislature did with respect to interstate commerce.

If after *Michelin* the legislature had enacted a statute imposing a substantially higher tax on imported goods than it imposed upon other goods, one could accept the conclusion that the statute constituted an invalid regulation of foreign commerce. It is difficult to understand, however, how the simple continuation of a pattern of taxation which validly existed for over 100 years can suddenly overnight be converted into an unconstitutional regulation of foreign commerce.

It is even more difficult to understand how the continuation of such a pattern in any way frustrates Congressional policy in establishing tariffs, as held by the lower court. To the best of petitioner's knowledge, Congress has never taken state property taxes into account in the imposition of tariffs on imported goods. It would be extremely difficult, if not impossible, for it to do so. There are 50 different states with widely different tax systems and tax rates. Some states, like New York, exempt all personal property, including inventories, from taxation. Other states, like California, tax personal property generally, but accord preferential treatment to inventories. Some 37 states have free

port laws under which goods brought into the state and held there temporarily for subsequent shipment outside the state are exempt from taxation. In many of such states goods brought into the state, including imported goods, for use or sale therein are subject to tax. In addition, the rates of taxation vary greatly between the different states and even between different political subdivisions of the same state. Furthermore, in many cases, as in the instant case, goods imported through the ports of a given seaboard state may be destined for sale or use in various interior states with tax policies differing one from the other and also different from that of the state of importation. In addition, the manufacturers to be protected by tariffs quite commonly sell their goods in a large number of states many of which have tax policies substantially different from those in other states. Under these circumstances it is impossible for Congress intelligently to take state tax burdens into account in fashioning the tariffs to be imposed on various imported goods.

The lower court's holding if carried to its logical conclusion would compel the invalidation of all the numerous and varying state taxing laws. Even if there were some merit to the lower court's holding, the effect of the statute in question is in the overall context *de minimis*.

The contemplation of the foregoing considerations forces one to the conclusion that the lower court's holding that the statute involved herein may frustrate Congress in the levying of tariffs is somewhat fanciful. Such a speculative foundation should not be permitted to stand as the basis for invalidating a state tax statute under the United States Constitution. Before a statute can be invalidated on such grounds, there should

be required a showing that there was an actual and substantial effect upon Congress' ability to regulate foreign commerce.

II.

State Taxing Statutes Should Not Be Required to Treat Foreign Commerce and Interstate Commerce With Meticulous Equality.

Prior to *Michelin* there was widespread, massive discrimination between the tax treatment of imported goods, on the one hand, and goods produced within a given state or brought into the state from other states, on the other. Thanks to *Michelin* such discrimination is no longer constitutionally mandated as it was in the past. However, we should not go over to the other extreme and require that state taxing statutes in order to be valid must treat all types of commerce—foreign, local, and interstate—exactly, precisely alike. Instead, reasonable differences should be permitted.

It should be noted that in the instant case, Section 225 does not exempt all imported goods, but only a relatively small segment thereof, *i.e.*, goods brought into the state for shipment outside the state. Otherwise, there is no difference in tax treatment between foreign commerce, local commerce, and interstate commerce.

Over the years a substantial volume of import businesses has developed in California. In the opinion of the Legislature, Section 225 was necessary to prevent the loss of a substantial portion of such business to states offering an exemption to imported goods similar to that provided by this section. The enactment of such section did not result in the imposition of any

new or unusual burdens on other forms of commerce. The historical differences between imports and interstate commerce make the classification a reasonabe one.

The fact that there is no hard and fast rule of equality in the area of taxation under consideration is indicated by the *Allied Stores* case. As noted previously, the court there held that a state could tax goods stored in the state by nonresidents more favorably than it taxed goods stored in the state by its own residents. Presumably, a similar rule would be upheld respecting goods stored in a state by nonresidents who are nonresidents of the United States. Thus, a state on the Canadian border might provide that goods stored in the state by residents of Canada should be exempt, whereas, goods stored therein by residents are taxable.

The court in the *Allied Stores* case upheld the exemption of goods of nonresidents on the grounds that it was a friendly policy. In the instant case, the state's policy of exempting goods imported for shipment and sale outside the state is also a friendly policy. Residents of other states who purchase goods which enter the country through California ports are relieved of additional costs which would otherwise result from the imposition of California taxes.

A hard and fast rule of equality, such as that proposed by the lower court, would lead to serious doubts as to the validity of various other state taxing policies. For instance, most states which impose personal income taxes exempt interest on their own bonds or the bonds of political subdivisions of such states. However, they tax residents on interest from bonds of other states, or political subdivisions thereof, and also on interest from bonds of foreign countries. This policy has been

in effect for a great many years. In California it has been in effect since the enactment of its personal income tax law in 1935.

California has carefully drafted credit provisions under which residents of the state are completely protected from double state taxation of the same income, and nonresidents are protected from such double taxation on a reciprocal basis. California does not, however, grant credit for taxes paid to foreign countries.

In determining the amount of income derived from California sources by multi-national corporations, subject to the California franchise tax, the state has long followed the policy of requiring that the total worldwide income from foreign countries must be taken into account and a portion thereof allocated to California by an appropriate allocation formula. In similar situations many, if not most, other states follow a different policy and permit the income from foreign countries to be excluded from the total income subject to apportionment.

In the case of such states there is obviously different treatment of income depending on source, *i.e.*, whether from domestic sources or foreign sources. Although there are exceptions, generally speaking, the exclusion of foreign income from the total income to be apportioned results in lower taxes than would otherwise be imposed.

In all of the above and numerous other instances which could be mentioned, a hard and fast rule of equality would give rise to serious questions of validity.

III.

The Extent if Any of Actual Discrimination Against Interstate Commerce Has Not Been Established.

Goods brought into the state from other states for subsequent shipment to and sale in still other states have long been subjected to California property tax laws. In order to avoid such taxes it is possible, even probable, that over the years dealers in goods moving in interstate commerce have arranged to divert many of such shipments to other states with more favorable tax laws.

California, like most states, has a fixed tax date. With rare exceptions not here relevant, unless goods are physically present in the state on such date, one day out of 365, they are not subject to tax. Again it is possible, even probable, that dealers in goods moving in interstate commerce commonly arrange for shipments of goods into California to be made after one tax date and to ship such goods out of the state to their final destination prior to the succeeding tax date.

By the above and other tactics dealers in goods moving in interstate commerce destined for sale in other states have been successful in escaping California taxes to a substantial extent, if not entirely. In any event, the record in this case is completely silent as to the volume of goods brought into the state from other states for shipment to and sale in still other states, and is likewise silent as to the amount, if any,

of California taxes imposed on such goods. Thus it may well be that the alleged discrimination against interstate commerce is more apparent than real. Apparent discrimination is not a sufficient basis to declare a state tax law unconstitutional under the United States Constitution.

Without any support in the record for finding that the statute either regulates foreign commerce or affects competition, the lower court held that the statute *per se* violates the Commerce Clause. The Court ignored established case law which holds that while the prohibition of the Import-Export clause of the Constitution against states' taxation is absolute, state tax laws affecting commerce are invalid only if they seriously and unreasonably burden commerce. *Richfield Oil Corp. v. State Bd. of Equalization* 329 U.S. 69 (1946).

The Court of Appeal's approach to the Commerce Clause contravenes established case law which rejects *per se* invalidity of state taxes affecting commerce in favor of a practical analysis that sustains state actions "which affect commerce unless the burden so imposed greatly exceeds the extent of the local benefits." *Aldens, Inc. v. Ryan,* 571 F.2d 1159, 1162 (10th Cir. 1978), citing *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). The clear trend of the Supreme Court is to expand the states' taxing power. *E.g., Michelin Tire Corp. v. Wages, supra; Washington Rev. Dept. v. Stevedoring Ass'n.,* 55 L.Ed.2d 682 (1978).

Conclusion.

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

HOWARD I. FRIEDMAN,
Attorney for Petitioner.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
THOMAS W. HENNING, Esq., and
LOEB AND LOEB,

and

ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

APPENDIX.

Opinion of the Court of Appeal.

In the Court of Appeal of the State of California, Second Appellate District, Division Three.

Zee Toys, Inc., Formosa Plastics Group (U.S.A.), Inc., Plaintiffs and Respondents, v. County of Los Angeles, and City of Long Beach, Defendants and Appellants. 2D Civ. No. 52977, 2D Civ. No. 53695, (Sup.Ct. No. C 179151).

Sears, Roebuck and Co., a corporation, Plaintiff and Respondent, v. County of Los Angeles and City of Compton, Defendants and Appellants. 2D Civ. No. 53306, (Sup.Ct. No. C 191156).

Filed: Oct. 25, 1978.

APPEALS from judgments of the Superior Court of Los Angeles County. Jack T. Ryburn and Campbell M. Lucas, Judges. Reversed.

John H. Larson, County Counsel, James Dexter Clark, Deputy County Counsel, for Defendants and Appellants.

Baker, Ancel and Redmond, Gerald T. Manpearl and Thomas C. Corcovelos, for Plaintiffs and Respondents Zee Toys and Formosa Plastics.

Loeb and Loeb, Frank M. Keesling, Andrew S. Garb, and Thomas W. Henning, for Plaintiff and Respondent Sears, Roebuck & Co.

These consolidated appeals are from summary judgments in two superior court actions which grant plaintiffs Zee Toys, Inc.. and Formosa Plastics Group (U.S.A.), Inc. (Sup. Ct. No. C 179151) and Sears, Roebuck and Co. (Sup. Ct. No. C 191156) refunds

of ad valorem taxes paid under protest. In the Zee case, the taxes had been collected for the benefit of defendants County of Los Angeles and City of Long Beach; in the Sears case, the taxes had been collected for the benefit of defendants County of Los Angeles and City of Compton, the city in each case being the situs of the goods taxed.

In both cases, the tax involved was ad valorem taxation levied upon tangible personal property in the possession of plaintiffs stored in warehouses in Los Angeles County on the tax lien dates. Such property had been manufactured outside the United States and brought to this state by the plaintiffs as importers.

The plaintiffs in both actions claimed an exemption from taxation for a percentage of such imported goods in their possession based upon the provisions of Revenue and Taxation Code sections 225 and 225.1. As then in effect, said sections read:

> "Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property." (Rev. & Tax. Code, § 225.)
>
> "A person claiming an exemption under Section 225 may either claim this exemption by (1) a

> percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof." (Rev. & Tax. Code, § 225.1.)[1]

The facts bearing upon the exempt status of the property were not in dispute. In the Zee case, the declarations showed that the plaintiffs were wholesale importers and distributors of goods manufactured outside the United States and distributed throughout the United States. Upon importation the goods were unloaded from the means of transportation at the plaintiffs' warehouses. They were then sorted by type and stored as inventory awaiting sale to plaintiffs' wholesale customers. Such inventory was normally "turned over" or replaced four to five times per year. While the goods were so stored, ad valorem property taxes were levied by defendants. Zee claimed that 90 percent of the inventory taxed was exempt and showed by uncontradicted declarations that during the year preceding the lien date, 90 percent of Zee's total shipments

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[1]The same provisions are now incorporated in Revenue and Taxation Code section 253.10, which was added by Statutes of 1977, chapter 246, section 7.

from the warehouses were to customers located outside of the State of California and 10 percent of such shipments were to customers located inside the State of California. Comparable percentages for Formosa were 63 percent of total shipments to customers located outside the State of California and 37 percent to customers located inside the state. In both instances, the declarations showed that none of the property was "in a manufacturing process or production."

Both Zee and Formosa filed claims for exemption which were denied. Thereafter they paid the taxes under protest and exhausted their administrative remedies before bringing suit. A declaration filed in behalf of defendants stated, without contradiction, that "there is a flow of traffic of substantial proportions by which goods arrive in California from other states for distribution throughout the United States or throughout various regions of the United States."

There was a stipulation of facts in the Sears case. This stipulation showed that the goods which were the subject matter of the litigation were manufactured or produced outside the United States and imported by Sears and placed in distribution warehouses "where they are held awaiting distribution to destinations both within and outside of the state . . . for the purpose of sale in the ordinary course of Sears' trade or business" which was "selling goods at retail." "The distribution warehouses located in the County of Los Angeles were devoted almost entirely to the distribution of goods which were imported from foreign countries, particularly from locations in the Pacific area." Sears had other warehouses not in the County of Los Angeles for the purpose of long-term storage. The rate of turnover

at the distribution warehouses averaged approximately three times per year. The goods were "meant to be shipped as quickly as distribution operations permit." Though no percentage was stated in the stipulation, the respective volumes of California and out-of-state shipments from the warehouses during the year preceding March 1, 1976, and the inventory on that date, were stated in an exhibit which resulted in a claim of exemption for property having a value of $19,373,089 by application of the percentage method specified in Revenue and Taxation Code section 221.5, subdivision (1).

The stipulation further stated that "Sears paid said tax under protest, claiming an exemption pursuant to Revenue and Taxation Code Sections 225 and 225.1, and thereafter duly exhausted its administrative remedies. No refund of any portion of said taxes was made to Sears, and this action was duly commenced."

Cross-motions for summary judgment were made by defendants in both cases. The motions of plaintiffs in each case were granted, and the cross-motions were denied. Judgments were entered for plaintiffs for refunds for the amount of their claims.

Contentions

The contentions of the respective parties are substantially similar in both cases. Defendants contend that (1) the exemption provided by Revenue and Taxation Code section 225 does not apply to the inventory of plaintiffs because, properly construed, such section provides only for the exemption of goods "in transit" through the state; (2) if section 225 is construed to exempt imported goods being held here at the pleasure of the owner for disposal or use, it violates the

United States Constitution by regulating interstate and foreign commerce and interfering with foreign affairs, since it extends no such exemption to interstate goods; (3) defendants have standing to raise this constitutional objection; and (4) the proper remedy is to invalidate the exemption, not extend it to interstate goods similarly held in this state.

Plaintiffs contend that (1) the clear language and purpose of Revenue and Taxation Code section 225 makes its exemption applicable to their imported goods, and forecloses the restrictive interpretation advanced by defendants; (2) defendants have no standing to raise their constitutional objection; (3) section 225 does not violate the United States Constitution; and (4) even if the selective exemption is invalid, the court has the power to correct the defect by extending the exemption to interstate goods.

Discussion

Summary

The language of Revenue and Taxation Code sections 225 and 225.1 is unequivocal. It does not simply codify the existing constitutional exemption of goods "in transit." Since it contains no ambiguity in this respect, it cannot be so interpreted to avoid constitutional objections. The selective exemption of goods of foreign origin, thereby giving them a competitive advantage over interstate goods, is a regulation of interstate and foreign commerce in violation of the Commerce Clause in the United States Constitution. It is, therefore, invalid. Defendants have standing to raise this constitutional objection. The proper remedy is to invalidate the exemption, not extend it to interstate goods.

Revenue and Taxation Code Sections 225 and 225.1 Clearly Exempt the Property in Issue

Section 225 exempts "property manufactured or produced . . . (2) outside of the United States and brought into this state *for transshipment out of this state*, for sale in the ordinary course of trade or business . . . ." (Italics added.) The exemption does not apply to "personal property in manufacturing process or production" but "[s]uch process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property."

Section 225 does not define "transshipment." Defendants point to dictionary definitions of "transshipment": for example, "to transfer from one ship, train, etc. to another" (Webster's New World Dict. (1968)) as supporting their contention "that this statute is declarative of existing commerce clause law," which exempts interstate and foreign goods "in transit."

Though defendants never specifically state what facts would be required to be shown to establish the exemption under this interpretation, inferentially the taxpayer would be required to prove that the goods had a specific further destination when they arrived in this state, that any interruption in their passage was "due to the necessities of the journey or for the purpose of safety and convenience in the course of the movement," and that they were not being "held there at the pleasure of the owner, for disposal or use, so that he may dispose of it either within the State, or for shipment elsewhere, as his interest dictates . . . ." (*Minnesota v. Blasius* (1933) 290 U.S. 1, 9-10 [78 L.Ed. 131].)

The "in transit" doctrine, which is applicable equally to foreign and interstate goods (cf. *Blasius*, which involved interstate goods, with *Carson Petroleum Co. v. Vial* (1929) 279 U.S. 95 [73 L.Ed. 626] and *Michelin Tire Corp. v. Wages* (1976) 423 U.S. 276, 302 [46 L.Ed.2d 495]) was well defined years before the adoption of section 225. The Legislature was no doubt familiar with the term "in transit"[2] used to refer to it. The term "transshipment" which the Legislature used, on the other hand, has not been used to describe goods protected by the "in transit" doctrine. The Legislature's use of the word "transshipment" does not, therefore, justify defendants' interpretation of the section.

Moreover, the meaning of transshipment as used in section 225 is clearly defined in section 225.1. Section 225.1 establishes two methods for claiming the exemption. The first is "a percentage method *of determining property held for transshipment* . . . at a particular location . . . ." (Italics added.) By establishing a method of determining what property is held for transshipment, this section necessarily defines "transshipment" as used in Revenue and Taxation Code section 225. The method specified is "by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year . . . ." The standard thereby established is totally inconsistent with the requirements of "in transit" status. It is even unnecessary that any of the goods on hand on tax day actually be shipped

[2]See Revenue and Taxation Code section 32051, enacted in 1955.

out of the state, and the determination method totally disregards the purpose of the interruption of the journey.

The alternative method specified in section 225.1 is equally inconsistent with the requirements of the "in transit" exemption. It only permits the exemption for goods possessed on tax day which actually are shipped out of state pursuant to contracts then in effect requiring such further shipment, but it totally ignores both the requirement that the interruption of the journey be "for the purpose of safety and convenience in the course of the movement," and the prohibition of the property "being held there at the pleasure of the owner, for disposal or use . . . ." (*Minnesota v. Blasius, supra*, 290 U.S. at p. 10.)

The standards for the determination of transshipment status stated in Revenue and Taxation Code section 225.1 are, therefore, inconsistent with and contrary to the standard for determination of the existence of "in transit" status.

In view of the standards thus unequivocally established in section 225.1 for "determining property held for transshipment," there is no room for interpretation of the scope of the exemption provided. "The intent of the Legislature must be ascertained from the language of the enactment and where, as here, the language is clear, there can be no room for interpretation." (*Caminetti v. Pac. Mutual L. Ins. Co.* (1943) 22 Cal.2d 344, 353-354.) Consequently, defendants' arguments that the statute must be construed to apply only to goods "in transit" (1) in order to avoid serious constitutional objections, and (2) to carry out the Legislature's view stated in the act adopting these sections that

"the net loss of revenues to any local agency is not significant"[3] are untenable.

Though as will appear, *infra,* we agree with defendants that sections 225 and 225.1 create an invalid exemption, we cannot avoid the necessity of so holding by placing an unacceptable interpretation upon the legislative language.

The Legislature's expressed understanding that the net loss of revenues to local agencies would not be significant falls into the same category; it cannot require a disregard of the clear language of the section.[4]

We, therefore, conclude that the property of the plaintiffs was exempt under the provisions of Revenue and Taxation Code section 225.

The Exemption Violates the Federal Constitution by Regulating Interstate and Foreign Commerce

In the absence of sections 225 and 225.1, inventory brought from outside the State of California and held in the manner employed by plaintiffs would be subject to ad valorem taxation regardless of whether its source was a foreign nation, or another state in the United States. Unless it qualifies as goods "in transit," inventory of interstate or foreign goods "held there at the pleasure of the owner, for disposal or use" is subject to nondiscriminatory ad valorem taxation. Until 1975, this rule was subject to a limitation

[3]Statutes of 1975, chapter 1126, section 4, page 2746.

[4]Moreover, in light of the constitutional doctrine exempting imports in the original package which was in effect at the time of enactment, it is not clear that the loss of revenue resulting from the exemption was necessarily significant. Most of the imports being held for transshipment probably were in their original packages.

with respect to foreign imports that they could not be so taxed while they remained in the original package. Such limitation, however, was removed by the decision of the United States Supreme Court in *Michelin Tire Corp. v. Wages, supra,* 423 U.S. 276, overruling prior decisions so construing Article 1, section 10, clause 2, of the United States Constitution prohibiting state imposts or duties on imports or exports.

As a result of *Michelin,* goods manufactured in a foreign country and imported to this state are subject to ad valorem taxes under like conditions as the same goods manufactured in another state and brought here. Both categories are constitutionally subject to ad valorem taxation by this state unless they remain "in transit." The effect of Revenue and Taxation Code sections 225 and 225.1, however, as we have held, is to exempt goods whose place of origin is a foreign country if it is established, pursuant to section 225.1, that they are held for further transport outside this state. No such exemption, however, is extended to goods whose place of origin is other states and which can similarly be shown to have been brought to this state for transshipment out of this state. For example, the same goods manufactured in Hawaii or Alaska and transported to California for distribution in the fashion employed by plaintiffs, would be subject to ad valorem taxation.

Different tax treatment is, therefore, accorded to such goods solely on the basis of their place of origin. Foreign goods are thereby given a competitive advantage over interstate goods of the same nature and competing in the same market.

Article 1, section 8, clause 3 of the United States Constitution provides that Congress shall have power

"[t]o regulate Commerce with foreign Nations, and among the several States and with the Indian Tribes." As stated in the concurring opinion of Justice Aiso in *Bethlehem Steel Corp. v. Board of Commissioners* (1969) 276 Cal.App.2d 221, 230-231:

> "The power to regulate commerce with foreign nations is an express grant by the people to the federal government. (*Gibbons v. Ogden* (1824) 22 U.S. (9 Wheat.) 1, 187-189 [6 L.Ed. 23, 68].) 'It is an essential attribute of the power that it is exclusive and plenary. As an exclusive power, its exercise may not be limited, qualified or impeded to any extent by state action. [Citations.] The power is buttressed by the express provision of the Constitution denying to the States authority to lay imposts or duties on imports or exports without the consent of the Congress. Art. 1, § 10, ¶ 2. [¶] The Congress may determine what articles may be imported into this country and the terms upon which importation is permitted.' (*University of Illinois v. United States* (1932) 289 U.S. 48, 56-57 [77 L.Ed. 1025, 1028; 53 S.Ct. 509, 510].)
>
> "'[T]o regulate commerce is to prescribe . . . the conditions upon which it shall be conducted; to determine how far it shall be free and untrammeled, how far it shall be burdened by duties and imposts, and how far it shall be prohibited.' *Welton v. Missouri* (1875) 91 U.S. 275, 279-280 [23 L.Ed. 347, 349].)"

In *Boston Stock Exchange v. State Tax Comm'n* (1977) 429 U.S. 318, 328 [50 L.Ed.2d 514], the high court said:

> "As in *Great A&P Tea Co. v. Cottrell*, 424 U. S. 366 (1976), we begin with the principle that '[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States.' *McLeod v. J. E. Dilworth Co.*, 322 U. S. 327, 330 (1944). It is now established beyond dispute that 'the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. . . . [*T*]*he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States.*' *Freeman v. Hewit*, 329 U. S. 249, 252 (1946)." (Italics added.)

The state imposition of discriminatory tax burdens upon interstate or foreign commerce necessarily limits, qualifies and impedes Congress' power to prescribe the conditions under which interstate and foreign commerce are to be conducted. The principal mode through which Congress has exercised its power to regulate competition between interstate and foreign commerce is by the imposition of import tariffs, designed for the most part to afford protection to United States manufactured goods threatened by foreign competition. As stated by the majority opinion in *Bethlehem Steel, supra*, 276 Cal.App.2d at page 226:

> "Only the federal government can fix the rules of fair competition when such competition is on an international basis. Foreign trade is properly a subject of national concern, not state regulation. State regulation can only impede, not foster, national trade policies."

For this reason, state taxes which discriminate between classes of interstate and foreign goods on the basis of their origin are not permitted. This is clear from the statement of the United States Supreme Court in *Michelin Tire Corp. v. Wages, supra,* 423 U.S. 276. In explaining why a nondiscriminatory tax was not prohibited, the court said (*id.*, at p. 286):

> "It is obvious that such nondiscriminatory property taxation can have no impact whatsoever on the Federal Government's exclusive regulation of foreign commerce, probably the most important purpose of the Clause's prohibition. By definition, such a tax does not fall on imports as such because of their place of origin. It cannot be used to create special protective tariffs or particular preferences for certain domestic goods, and it cannot be applied selectively to *encourage* or *discourage* any importation in a manner inconsistent with federal regulation." (Italics added.)

More recently, the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274 [51 L.Ed.2d 326], referred to a discriminatory tax as a "tailored tax," noting that "property taxes also may be tailored to differentiate between property used in transportation and other types of property. . . . A tailored tax, however accomplished, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." (*Id.*, at pp. 288-289, fn. 15.)

Contrary to plaintiffs' claim that the only discrimination interdicted by the Commerce Clause is discrimination in favor of local commerce and against interstate or foreign commerce, the decision in *Boston Stock*

Exchange v. State Tax Comm'n, supra, 429 U.S. 318, holds that discriminatory tax burdens which favor one class of commerce, subject to the control of Congress, over another such class, are equally prohibited. In that case, a state tax which discriminated between two types of interstate transactions was struck down. The court said (*id.*, at p. 335):

> "There has been no prior occasion expressly to address the question whether a State may tax in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses, but the clear import of our Commerce Clause cases is that such discrimination is constitutionally impermissible."

Discrimination between (1) interstate transactions and foreign transactions cannot be distinguished from (2) discrimination between two types of interstate transactions. Both interstate and foreign transactions are brought within the control of Congress by the same clause of the United States Constitution.

In any event, there is no merit to the argument that only the imposition of discriminatory burdens upon foreign commerce interferes with Congress' power to regulate in that field. As pointed out in *Michelin, supra,* 423 U.S. at page 286, discriminatory taxes, if "applied selectively to *encourage* or discourage . . . importation in a manner inconsistent with federal regulation" are invalid. (Italics added.) The capacity of such selective taxation to interfere with Congress' power is easily illustrated: Congress concludes that American producers require protection from the competition of Japanese transistor radios and imposes a tariff deemed sufficient to accomplish such protection. A California

tax exemption favoring the foreign product offsets the tariff in respect of goods imported through this state with the result that the competitive advantage intended by Congress is diminished *pro tanto*.

The imposition of discriminatory burdens is not saved by the fact that they are imposed after the interstate or foreign goods have become incorporated into the mass of property of the state. In *Boston Stock Exchange v. State Tax Comm'n, supra,* 429 U.S. at pages 332-333, footnote 12, the court said:

> "Because of the discrimination inherent in § 270-a, we also reject the Commission's argument that the tax should be sustained because it is *imposed on a local event at the end of interstate commerce*. While it is true that, absent an undue burden on interstate commerce, the Commerce Clause does not prohibit the States from taxing the transfer of property within the State, the tax may not discriminate between transactions on the basis of some interstate element. *International Harvester Co. v. Department of Treasury,* 322 U.S. 340, 347-348 (1944). As was held in *Welton v. Missouri,* 91 U. S. 275, 282 (1876): '*[T]he commercial power [of the Federal Government] continues until the commodity has ceased to be the subject of discriminating legislation by reason of its foreign character. That power protects it, even after it has entered the State, from any burdens imposed by reason of its foreign origin.*' " (Italics added.)

The fact that there may be rational grounds for the state to exempt imported goods destined for transshipment to another state which do not apply to interstate goods in the same category cannot validate the

exemption. It may be that there is a greater threat of business flight from California by importers accustomed to the benefits of the original package doctrine than by distributors of interstate goods. But such considerations do not justify a state's utilization of a tax differential as a means of regulating interstate and foreign commerce. Only Congress is authorized to so act. Referring to comparable state policies urged in support of the California Buy American Act, the majority opinion said in *Bethlehem Steel Corp. v. Board of Commissioners, supra,* 276 Cal.App.2d at pages 225-226:

> "That there are countervailing state policies which are served by the retention of such an act is 'wholly irrelevant to judicial inquiry' (*United States v. Pink,* 315 U.S. 203, 233 [86 L.Ed. 796, 819, 62 S.Ct. 552]) since '[i]t is inconceivable that any of them can be interposed as an obstacle to the effective operation of a federal constitutional power.' (*United States v. Belmont, supra,* 301 U.S. 324, 332 [81 L.Ed. 1134, 1140].)"

If the defendants were invoking the Equal Protection Clause of the United States Constitution, the existence of a rational basis for the discrimination would be an answer to their claims. (Cf. *Allied Stores of Ohio v. Bowers* (1959) 358 U.S. 522, 529 [3 L.Ed.2d 480].) But no authority has been cited suggesting that policy considerations grounded in the state's desire to avoid business flight to another state can be the basis for usurping Congress' commerce power. Exactly such considerations were found not to be sufficient to validate such state action in *Boston Stock Exchange v. State Tax Comm'n, supra.*

We conclude, therefore, that by granting an exemption to foreign goods which is withheld from interstate goods, Revenue and Taxation Code section 225 violates the Commerce Clause of the United States Constitution.

Defendants Have Standing to Raise the Unconstitutionality of the Exemption

Plaintiffs challenge the standing of defendants, as mere political subdivisions of the state, to invoke any federal constitutional objection to the enactments of the California Legislature. They rely upon the decision of this court in *Community Television of So. Cal. v. County of Los Angeles* (1975) 44 Cal.App.3d 990, and upon *Appeal of Martin* (1974) 286 N.C. 66 [209 S.E.2d 766]. In *Community Television,* the County of Los Angeles claimed that a tax exemption was "unconstitutional as a violation of the equal protection clauses of the federal and state Constitutions" (44 Cal.App.3d at p. 998) by discriminating in favor of some charitable organizations and against others without logical basis. The court refused to consider this constitutional objection, (though it did discuss another purely state constitutional objection—the prohibition against gifts of public funds), saying (*ibid.*):

> "We need not dwell long on this argument since the appellants are in no position to raise the issue. As a political subdivision of the state and not being parties who belong to a class allegedly discriminated against they lack the standing to make such a challenge. (*City of New York v. Richardson,* 473 F.2d 923; *Data Processing Service v. Camp,* 397 U.S. 150 [25 L.Ed.2d 184, 90 S.Ct. 827]; *Flast v. Cohen,* 392 U.S. 83 [20 L.Ed.2d 947, 88 S.Ct. 1942]; *Harman v. City and County of San Francisco,* 7 Cal.3d 150 [101 Cal.Rptr. 880, 496 P.2d 1248].)"

Appeal of Martin involved a challenge to tax legislation on the basis of a state constitutional requirement of "uniformity." The taxing county was denied standing on dual grounds: first, that it was voluntarily proceeding under the statute claiming benefits thereunder and would not be heard " 'to question its constitutionality in order to avoid its burdens.' " (209 S.E.2d at p. 772.) The other ground for holding lack of standing was:

> "Finally, the County is precluded from challenging the constitutionality of G.S. § 105-281 (1969 Cum.Supp.) on yet another ground: It is not a member of the class subject to the alleged discrimination. State v. Trantham, 230 N.C. 641, 55 S.E.2d 198 (1949); State v. Sims, 213 N.C. 590, 197 S.E. 176 (1938)." (*Id.,* at pp. 772-773.)

Neither case is controlling. As above noted, the objection urged in this case by the defendants is not based upon equal protection. The requirement that the parties "belong to a class allegedly discriminated against" is, therefore, inapplicable. The only function of the discriminatory nature of the tax is to demonstrate its capacity to interfere with the authority of Congress over commerce. The interest herein sought to be protected is not personal to dealers in nonexempt interstate

goods; it relates more to the national interest in observing the boundaries of state and federal power.

A comprehensive discussion of this standing question appears in the opinion of the Second Circuit in *City of New York v. Richardson* (1973) 473 F.2d 923, which dealt with the validity of financing and reimbursement policies established by the Social Security Act and the New York Social Services Law. The court upheld the trial court's dismissal of the city's claims based upon equal protection, on the ground of lack of standing. It held, however, that the plaintiffs, who had sued in their official capacities as Mayor and Commissioner of Social Services of the City of New York, did have standing. The court said in this respect (*id.*, at p. 933):

> "With respect to standing, those plaintiffs who sued in their official capacities may assert constitutional claims against the state under the rule announced in Board of Education v. Allen, 392 U.S. 236, 241, n. 5, 88 S.Ct. 1923, 20 L.Ed.2d 1060 (1968). This is so because of the conflict each of these officials must face between his sworn duty to uphold the Constitution of the United States and his responsibility for administering New York's allegedly unconstitutional Social Services Law."

In *Board of Education v. Allen* (1968) 392 U.S. 236 [20 L.Ed.2d 1060], cited above, the United States Supreme Court noted the standing of officials of a school district to challenge the constitutionality of the law requiring them to loan textbooks free of charge to students attending private schools. After stating that the New York Court of Appeals had "concluded by

a 4-3 vote that appellants did have standing," the court explained the basis of this standing as follows (*id.*, at p. 241, fn. 5):

> "Appellants have taken an oath to support the United States Constitution. Believing § 701 to be unconstitutional, they are in the position of having to choose between violating their oath and taking a step—refusal to comply with § 701—that would be likely to bring their expulsion from office and also a reduction in state funds for their school districts. *There can be no doubt that appellants thus have a 'personal stake in the outcome' of this litigation. Baker v. Carr,* 369 U. S. 186, 204 (1962)." (Italics added.)

Though the instant suits are, in form, actions against the city and county and not against any of the county's officers, the substance of the action is a test of the propriety of the Board of Supervisors' refusal to refund plaintiffs' taxes. Revenue and Taxation Code section 5096 provided in pertinent part at the time the actions were commenced:

> "On order of the board of supervisors, any taxes paid before or after delinquency shall be refunded if they were:
>
> ". . . .
>
> "(b) Erroneously or illegally collected."[5]

Suits for refund of taxes paid under protest, which the Supervisors refused to refund, were authorized by Revenue and Taxation Code sections 5103 and 5138, The pertinent portion of section 5103 read as follows:

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[5]This included taxes collected by county officers for defendant cities. (Rev. & Tax. Code, § 5099.)

> "If the board of supervisors or city council rejects a claim for refund in whole or in part, the person who paid the taxes, his guardian, executor, or administrator may within six months after such rejection commence an action in the superior court against the county or a city to recover the taxes which the board of supervisors or the city council have refused to refund."

The present provision, which supersedes both prior sections, is Revenue and Taxation Code section 5140; it reads:

> "The person who paid the tax, his guardian, the executor of his will, or the administrator of his estate may bring an action in the superior court against a county or a city to recover a tax which the board of supervisors of the county or the city council of the city has refused to refund on a claim filed pursuant to Article 1 (commencing with Section 5096) of this chapter. No other person may bring such an action; but if another should do so, judgment shall not be rendered for the plaintiff."

It is thus apparent that the statutorily required form of action to test the propriety of the supervisors' refusal to order a refund of taxes erroneously or illegally collected is a suit against the county. It is "the general rule that the existence of an action at law to recover a refund precludes resort to an extraordinary writ to attack the alleged illegal or erroneous levy of a tax." (*Kahn v. East Bay Mun. Util. Dist.* (1974) 41 Cal. App.3d 397, 407.)

The Board of Supervisors, like all other public officers, were required to take an oath of office which

included the undertaking to "support and defend the Constitution of the United States" as well as to "faithfully discharge the duties" of their office. (Cal. Const., art. XX, § 3; Gov. Code, § 1360.) The conflict between the duties of the Supervisors under the Constitution of the United States and those which were imposed by Revenue and Taxation Code section 225 justifies the assertion of the constitutional claims by the county, where the propriety of the Supervisors' refusal to order a refund depends upon the constitutionality of the exemption. The control of the litigation is in the hands of the Supervisors, the propriety of their conduct is the issue; thus, they are real if not technical parties to the action.

The general standard for determining standing also is met. As our Supreme Court said in *Harman v. City and County of San Francisco* (1972) 7 Cal.3d 150, 159:

> " 'The fundamental aspect of standing is that it focuses on the party seeking to get his complaint before a . . . court, and not in the issues he wishes to have adjudicated.' (*Flast v. Cohen, supra,* [392 U.S.] at p. 99 [20 L.Ed.2d at p. 961].) A party enjoys standing to bring his complaint into court if his stake in the resolution of that complaint assumes the proportions necessary to ensure that he will vigorously present his case. (*Baker v. Carr* (1962) 369 U.S. 186, 204 [7 L.Ed.2d 663, 678, 82 S.Ct. 691].) As Professor Jaffe has stated, we must determine standing by a measure of the 'intensity of the plaintiff's claim to justice.' (Jaffe, *supra,* 75 Harv.L.Rev. at p. 304.)"

The defendants, as local agencies largely dependent upon ad valorem taxation to provide funds for necessary local services, have reason to "vigorously present" the constitutional questions, and have done so. The Supervisors, who control the county's conduct of the litigation, have a significant "personal stake in the outcome" of the litigation which will resolve the conflict between their duties under the United States Constitution and the duties of their office.

Under the circumstances, no valid purpose would be served by prolonging the uncertainty as to the validity of significant tax legislation on the basis of the form of the actions. We, therefore, conclude that the constitutionality of the exemption is properly before this court.

The Exemption May Not Be Judicially Broadened to Include Interstate Goods

Plaintiffs suggest that if the exemption provided by Revenue and Taxation Code section 225 is invalid because it is not also made applicable to goods whose origin is interstate commerce, the proper remedy is to judicially broaden the exemption to include the interstate goods. They cite in this respect the opinion of our Supreme Court in *Haman v. County of Humboldt* (1973) 8 Cal.3d 922. In *Haman,* the plaintiffs sought to recover the property tax they paid on their fishing boats for the calendar year 1968, in excess of the amount they would have been required to pay under Revenue and Taxation Code section 227, subdi-

vision (a), if their port of documentation were in the State of California.

Section 227 provided that:

> "A documented vessel, . . . shall be assessed at one percent (1%) of its full cash value only if:
>
> "(a) The port of documentation is in this state.
>
> "(b) The vessel is engaged or employed exclusively:
>
> "(1) In the taking and possession of fish or other living resource of the sea for commercial purposes, or
>
> "(2) In instruction or research studies as an oceanographic research vessel."

The port of documentation requirement was held an invalid discrimination against California residents owning fishing boats documented in other states. The court then considered the relief to be granted and stated in this respect:

> "In cases involving invalid differentials in tax treatment, the court has the *power* to eliminate the discriminatory treatment either by granting those taxpayers, who have been assessed the higher rate, a refund based on the difference between the lower rate and the one under which they were assessed, i.e., taxing all vessels at 1 percent, or by providing that in the future the board of equalization adjust the assessment rolls so that the higher rate will be applied to all like taxpayers. (*Security-First Nat. Bk. v. County of L. A.*, 35 Cal.2d 319, 322 [217 P.2d 946]; *Jones Lbr. Co. v. Del Norte County,* 251 Cal.App.2d 645,

650 [59 Cal.Rptr. 644].) In determining the proper remedy, we must adopt the one which will best further the legislative intent without increasing discrimination among other taxpayers.

"The main purpose of the 1 percent assessment is obviously to aid California's ailing fishing industry. The statute requires that as well as having a port of documentation within the state, the vessel must be '. . . engaged or employed exclusively: (1) In the taking and possession of fish or other living resource of the sea *for commercial purposes,* . . .' (Italics added.) . . . .

"We conclude that the legislative intent is properly carried out by holding invalid subdivision (a) of section 227, which requires that the port of documentation be within this state, and by upholding the balance of the section. Accordingly, plaintiffs are entitled to a refund. [Fn. omitted.]" (*Haman v. County of Humboldt, supra,* 8 Cal.3d at pp. 928-929.) (Italics added.)

Assuming that the process described in *Haman* is equally applicable to exemptions as it is to rate differentials,[6] we conclude that the legislative intent is properly carried out in this case by holding invalid the exemption of goods manufactured outside the United States and brought to California for transshipment, and denying refund.

As the statement in *Haman* indicates, by considering an alternative of "providing that in the future" the higher rate will be applied to all boat owners, the

[6]The constitutional authority for exemptions and rate differentials is found in the same article XIII, section 2 of the California Constitution which states: "The Legislature, two-thirds of the membership of each house concurring, may classify such personal property for differential taxation or for exemption."

inquiry into legislative intent must be made on a prospective basis. We must, therefore, assess the situation in light of present circumstances.

Plaintiffs argue that the legislative history indicates the principal purpose of Revenue and Taxation Code section 225 was to promote utilization of California ports and discourage removal of import business to states with a more favorable tax structure. This purpose, they say, can best be furthered by enlarging the exemption to include interstate goods, whereas it would be totally frustrated by invalidating the exemption of foreign goods.

There are, however, other factors to consider. The Legislature clearly indicated in the enacting statute that it did not intend thereby to deprive local agencies of significant revenue. Section 4 of the act stated:

> "No appropriation is made by this act, nor is any obligation created thereby under Section 2229 of the Revenue and Taxation Code, for the reimbursement of any local agency for any revenue lost by it as a result of the exemption of property from taxation by this act because the net loss of revenues to any local agency is not significant." (Stats. 1975, ch. 1126, p. 2746.)

Unquestionably, the Legislature's estimate of the revenue loss was made in view of the then existing original package doctrine which effectively exempted foreign goods from local ad valorem taxation. Most of the imports exempted by Revenue and Taxation Code section 225 would be exempt anyway on the basis of said doctrine. However, subsequent to the enactment of section 225, the United States Supreme Court in *Michelin Tire Corp. v. Wages, supra,* overruled the original package doctrine and made all imported goods, no

longer "in transit," subject to nondiscriminatory local ad valorem taxation. After the decision in *Michelin*, the effect of section 225 is clearly to deprive local agencies of significant revenue, as the judgments in these cases demonstrate. (The judgment in Sears' favor alone exceeded $284,000 with respect to a single year.) We cannot assume that the Legislature would have approved section 225 had it understood that a loss of any such proportions was involved. There is even less basis to assume that the Legislature would be willing to subject local agencies to the additional deprivation of revenue which would inevitably result from expanding the exemption to include goods originating in interstate commerce, which were being taxed. This is especially true in view of the subsequent adoption of Proposition 13, critically reducing the tax base of local agencies to a level which the Legislature apparently considers inadequate for the rendition of required local services, as evidenced by the action taken to provide state funds for such purpose.

Cognizance must also be taken in this respect to the fact that since 1939 the Legislature has indicated that an exemption from taxation is not intended unless express provision be made therefor. Revenue and Taxation Code section 201 has provided: "All property in this State, not exempt under the laws of the United States or of this State, is subject to taxation under this code." Consequently, when section 225 was enacted limiting the exemption to goods manufactured outside the United States, it expressly denied the exemption to goods manufactured in other states.

We may also assume that in acting in respect to this matter, the Legislature would be guided by the

purpose of the California constitutional provisions governing tax exemptions. As our Supreme Court stated in *Watchtower B. & T. Soc. v. County of L.A.* (1947) 30 Cal.2d 426, 429, referring to California Constitution, article XIII, section 1: "The purpose of that provision is to secure equality of taxation which results from subjecting all property to the same burden."

In the same vein, the court in *County of Amador v. State Board of Equalization* (1966) 240 Cal.App.2d 205, 224, said: "Without regard to the identity of the assessing agency, article XIII, section 1, of the Constitution requires that all property be taxed in proportion to its value. The constitutional goals are equality and uniformity."

Since we find no reasonable basis for the assumption that the Legislature would, in light of present circumstances, prefer extending the exemption, any attempt on our part to broaden the exemption would violate the requirement of article XIII, section 2, of the California Constitution that the creation of exemptions be approved by a vote of two-thirds of the Legislature. We consequently hold that the discriminatory exemption created by the statute is invalid, and that plaintiffs' goods are properly subject to taxation.

The judgments are reversed and both causes remanded to the trial court which is directed to enter judgments in favor of defendants.

CERTIFIED FOR PUBLICATION

Potter, *Acting P. J.*

We concur:

Cobey, *J.*

Allport, *J.*

APPENDIX B.

California Revenue and Taxation Code.

§ 225. Personalty in transit.

Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

Supreme Court, U. S.
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AUG 22 1979
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No. 78-1577

In the Supreme Court of the United States

OCTOBER TERM, 1978

SEARS, ROEBUCK AND CO., PETITIONER

v.

COUNTY OF LOS ANGELES AND CITY OF COMPTON

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

WADE H. McCREE, JR.
Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney
Department of Justice
Washington, D.C. 20530

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's invitation of June 4, 1979.

OPINIONS BELOW

The order of the trial court is not officially reported. The opinion of the Court of Appeal (Pet. App. 1-29) is reported at 85 Cal. App. 3d 763. The denial by the Supreme Court of California of a petition for hearing (Pet. 2) is reported at 149 Cal. Rptr. 764.

JURISDICTION

The decision of the Court of Appeal was entered on October 25, 1978 (Pet. 2; Pet. App. 1). The Supreme Court of California denied petition for hearing on

January 17, 1979 (Pet. 2). The petition for a writ of certiorari was filed on April 16, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(3).

QUESTION PRESENTED

The United States will discuss the following question: Whether the California property tax exemption for personalty manufactured or produced (1) outside California and brought into the State for transshipment out of the United States; or (2) outside of the United States, and brought into California for transshipment out of the State, for sale in the ordinary course of trade or business, is invalid under the Commerce Clause of the United States Constitution.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes".

Sections 225 and 225.1 of the Cal. Rev. & Tax. Code (West), enacted by 1975 Cal. Stats., ch. 1126, at 2746, §§ 1 and 2, during the period here involved,[1] provided as follows:

> §225. *Personalty brought into state for transshipment outside state or United States; exemption*
>
> Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.
>
> §225.1. *Method of claiming transshipment exemption*
>
> A person claiming the transshipment exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

[1] Although Section 225.1 of the Cal. Rev. & Tax. Code (West) was repealed by 1977 Cal. Stats., ch. 246, §4, its provisions were simultaneously reenacted as Section 253.10 of the Rev. & Tax. Code, by 1977 Cal. Stats., ch. 246, §7.

STATEMENT

Petitioner brought this suit for refund of ad valorem personal property taxes paid under protest to the County of Los Angeles and the City of Compton.

The facts were stipulated (Pet. App. 1-2, 4) and may be summarized as follows: Petitioner is engaged in the business of selling goods at retail, both in California and

elsewhere. On March 1, 1976, the tax lien date for purposes of the annual California ad valorem tax on personal property, petitioner held tangible personal property in warehouses in the County of Los Angeles and City of Compton. The property in question had been manufactured or produced outside the United States, and had been imported by petitioner and placed in warehouses for distribution both within and without California for purposes of sale in the ordinary course of petitioner's business. Petitioner's distribution warehouses in the County of Los Angeles were devoted almost entirely to goods imported from foreign countries, particularly from locations in the Pacific area. The rate of turnover at the warehouses averaged approximately three times per year. Petitioner intended to ship the goods as quickly as its distribution operations permitted. Pursuant to Sections 225 and 225.1 of the California Revenue and Taxation Code, petitioner applied to the total amount of goods manufactured or produced outside the United States and held in its warehouses in Los Angeles County on March 1, 1976, the fraction represented by the out-of-state shipments from those locations during the preceding year divided by the total shipments from those locations during that year. Petitioner accordingly claimed a transshipment property tax exemption for property having a value of $19,373,089 (Pet. App. 1-3, 4-5).

Respondents denied the claimed exemption. They asserted (1) that properly construed, Section 225 exempted only goods in transit through the State, and (2) that even if Section 225 were construed to exempt imported goods held in the State by the owner for disposal or use, it would violate the United States Constitution by regulating interstate and foreign commerce in interfering with foreign affairs, because it extended no exemption to interstate goods. Petitioner

thereupon paid the tax under protest and instituted this action for refund in the Superior Court of Los Angeles County. The Superior Court upheld petitioner's claimed exemption (Pet. App. 1-2, 5-6).

The Court of Appeal reversed (Pet. App. 29). Although it rejected respondents' statutory argument that Section 225 applied only to goods "in transit" (Pet. App. 7-10), it held that the statutory exemption of foreign goods regulated interstate and foreign commerce and was therefore invalid under the Commerce Clause of the United States Constitution (Pet. App. 6, 10-18). It also suggested that the exemption interfered with the power of the Congress to impose tariffs (Pet. App. 15-16). In the Court of Appeal's view, the statutory exemption gave goods of foreign origin a competitive advantage over goods manufactured in other states and brought to California for transshipment in interstate commerce. It concluded that "state taxes which discriminate between classes of interstate and foreign goods on the basis of their origin are not permitted" (Pet. App. 14). With three Justices dissenting, the Supreme Court of California denied a petition for hearing (Pet. 2).

ARGUMENT

In holding that the California property tax exemption for foreign goods destined for interstate commerce or out-of-state goods destined for export violates the Commerce Clause of the Constitution and interferes with Congress' power to impose tariffs, the Court of Appeal misinterpreted the decisions of this Court.

1. Section 225 of the California Revenue and Taxation Code exempts from taxation while held in California, imported goods destined for other states and goods from other states destined for export. It does not, however,

exempt domestic goods destined for interstate commerce. On the authority of this Court's decision in *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977), the Court of Appeal held that the statute unconstitutionally discriminated against interstate commerce and therefore violated the Commerce Clause. But *Boston Stock Exchange* has no bearing on the question presented in this case. The prohibited discrimination in that case was one that provided "a direct commercial advantage to local business" by virtue of "laws that favor local enterprise at the expense of out-of-state business" (429 U.S. at 329) by taxation "in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state business" (*id.* at 335).

Here, in contrast, the statutory property tax exemption did not favor local business at the expense of out-of-state business. It favored imports and exports.[2] There is, however, no constitutional prohibition against favoring imports over domestic goods. The Import-Export Clause of the Constitution itself makes such a differentiation. The decisions of this Court have therefore consistently held invalid state statutes that have had an adverse impact upon foreign nationals or upon foreign commerce.[3] Nor

[2]Cf. *Allied Stores of Ohio* v. *Bowers*, 358 U.S. 522 (1959). There, the issue was addressed under the Equal Protection Clause of the Fourteenth Amendment rather than under the Commerce Clause.

[3]See, *e.g.*, *Ware* v. Hylton, 3 U.S. (3 Dall.) 199 (1796); *Fairfax's Devisee* v. *Hunter's Lessee*, 11 U.S. (7 Cranch) 603 (1813); *Brown* v. *Maryland* 25 U.S. (12 Wheat.) 419 (1827); *Henderson* v. *Mayor of New York*, 92 U.S. 259 (1875); *Chy Lung* v. *Freeman*, 92 U.S. 275 (1875); *Hauenstein* v. *Lynham*, 100 U.S. 483 (1879); *People* v. *Compagnie Gen. Transatlantique*, 107 U.S. 59 (1882); *Asakura* v. *Seattle*, 265 U.S. 332 (1924); *Nielsen* v. *Johnson*, 279 U.S. 47 (1929); *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414 (1940); *Hines* v. *Davidowitz*, 312 U.S. 52 (1941); *Kolovrat* v. *Oregon*, 366 U.S. 187 (1961); *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964); *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964); *Zschernig* v. *Miller*, 389 U.S. 429 (1968).

does the Commerce Clause require a different result. As this Court reaffirmed in *Washington Rev. Dept.* v. *Stevedoring Assn*, 435 U.S. 734, 751 (1978), "[T]he Import-Export Clause states an absolute ban, whereas the Commerce Clause merely grants power to Congress." See also *Richfield Oil Corp.* v. *State Board*, 329 U.S. 69, 75 (1946).

When only the Commerce Clause is involved, this Court only last Term in *Japan Line, Ltd.* v. *County of Los Angeles*, decided April 30, 1979 (No. 77-1378), explicitly rejected the premise that "Commerce Clause analysis is identical, regardless of whether interstate or foreign commerce is involved. * * * When construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required." (Slip op. 11-12). *Japan Line* held that shipping containers employed in foreign commerce, based and owned in Japan, were not subject to the apportioned property taxation to which domestic shipping containers engaged in interstate commerce would have been subject.[4] Although this Court in *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276 (1976), held that a state was not constitutionally required to exempt imports held in the original package from generally imposed property taxation, nothing in the decision suggested that the exemption that had previously been constitutionally required under decisions overruled by *Michelin Tire* was thereafter constitutionally prohibited.

As the Court in *Michelin Tire* pointed out (423 U.S. at 283-294), the considerations underlying the Import-Export Clause were that the federal government speak with one voice in regulating commercial regulations with

[4]See *Ott* v. *Mississippi Barge Line*, 336 U.S. 169 (1949); *Braniff Airways* v. *Nebraska State Board*, 347 U.S. 590 (1959).

foreign governments, that import revenues not be diverted to the states, and that seaboard states with ports of entry not be permitted to be toll-takers at the expense of states not situated as favorably geographically. The California statute serves all of these purposes. The fact that it serves and advances constitutional policy somewhat more fully than the minimum required of the state[5] does not justify the Court of Appeal's ruling that it violates the Commerce Clause.

During the more than 100 years prior to the *Michelin Tire* decision, while the rule of *Low* v. *Austin*, 80 U.S. (13 Wall.) 29 (1871) and *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652 (1945), required exemption of imported goods in original packages from generally imposed state property taxes, the Court consistently held that goods that had moved in interstate commerce in their original packages enjoyed no comparable exemption.[6] When the Court overruled *Low* and *Hooven*, it was not on the basis of any discrimination favoring imports over goods in interstate commerce, but only because the considerations that gave rise to the Import-Export Clause did not require

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[5]Even before the *Michelin Tire* decision, the California exemption was somewhat broader than the minimum then constitutionally required. By its terms, the exemption for imports persisted beyond the original package, for it permitted breaking bulk, repackaging, etc. With regard to goods held for export, it granted exemption prior to movement in the stream of exportation, as defined by this Court's decisions in *Empresa Siderurgica* v. *Merced Co.*, 337 U.S. 154 (1949) and *Joy Oil Co.* v. *State Tax Comm'n.*, 337 U.S. 286 (1949). It is not questioned, however, that the goods exempted from tax were goods that had been imported and goods that were subsequently exported.

[6]*Woodruff* v. *Parham*, 75 U.S. (8 Wall.) 123 (1868); *Brown* v. *Houston*, 114 U.S. 622 (1885); *American Steel & Wire Co.* v. *Speed*, 192 U.S. 500 (1904); *Sonneborn Bros.* v. *Cureton*, 262 U.S. 506, 509, 510-513 (1923); *Wiloil Corp.* v. *Pennsylvania*, 294 U.S. 169 (1935).

exemption. Nothing in *Michelin Tire* suggested that the pre-existing exemption was now to be constitutionally prohibited.[7]

In sum, the decisions of this Court involving imports, exports, and foreign commerce uniformly emphasize that one of the principal purposes of the Constitution was to assure that the states did not impede or obstruct importation, exportation, or foreign commerce. The Court in *Michelin Tire* overruled *Low* v. *Austin* only when it was demonstrated that application of a generally imposed property tax to imports in the original package did not substantially impede importation or foreign commerce. *Washington Rev. Dept.* v. *Stevedoring Assn.*, 435 U.S. 734, 751-755 (1978). By favoring imports and exports, Section 225 of the California Revenue and Taxation Code facilitates importation and exportation and assures that imports and exports passing through the state will not be impeded even to the extent of the impact of a generally applicable property tax. While such action

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[7]Indeed, in contexts other than property taxes on goods in the original package, the Court has treated imports or exports markedly differently from goods shipped in interstate commerce. Compare *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964) and *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964) with *State Board* v. *Young's Market Co.*, 299 U.S. 59 (1936) and *Brewing Co.* v. *Liquor Comm'n.*, 305 U.S. 391 (1939); *Crew Levick Co.* v. *Pennsylvania*, 245 U.S. 292 (1917) with *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250 (1938); *Carson Petroleum Co.* v. *Vial*, 279 U.S. 95 (1929) with *General Oil Co.* v. *Crain*, 209 U.S. 211 (1908), *Bacon* v. *Illinois*, 227 U.S. 504 (1913), and *Minnesota* v. *Blasius*, 290 U.S. 1 (1933).

Carson Petroleum Co. v. *Vial*, *supra*, may have been heavily qualified by the decision in *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949), as the dissent in the latter case asserted (337 U.S. at 291-292). But the result in *Carson Petroleum* was distinguished from other contemporary decisions principally by the fact that the oil involved was destined for export (see 279 U.S. at 106-109).

may not be constitutionally required, it is not, as the decision below erroneously held, constitutionally prohibited. Nothing in the Commerce Clause prevents a state from favoring imports and exports beyond the extent required by the Import-Export Clause.

2. a. In further support for its invalidation of the statutory exemption for imported goods, the Court of Appeal suggested (Pet. App. 15-16) that Section 225 impedes the power of the Congress to determine the effective tariff applicable to imported goods. But this reasoning is contrary to this Court's analysis in *Michelin Tire*. In considering the effect of removing the exemption for imported goods required by earlier decisions, the Court pointed out (423 U.S. at 287): "It may be that such taxation could diminish federal impost revenues to the extent its economic burden may discourage purchase or importation of foreign goods. The prevention or avoidance of this incidental effect was not, however, even remotely an objective of the Framers in enacting the prohibition."

b. Furthermore, Sections 4271 and 4272 of the Internal Revenue Code of 1954 show that the California exemption for imports and exports is entirely consistent with congressional policy. Section 4271 imposes a tax of 5 percent upon the amount paid for transportation of property by air, but Section 4272(a) limits this to "transportation by air which begins and ends in the United States." Section 4272(b) excludes from tax, under regulations prescribed by the Secretary, "transportation of property in the course of exportation * * * by continuous movement, and in due course so exported."

Under Treasury Temporary Regulations in Connection with the Airport and Airway Revenue Act of 1970 (26 C.F.R.), Section 154.2-1(c)(1) and (2), transportation will

be considered to begin and end at the points of origin and destination as shown by a through airwaybill, or, if no such airwaybill has been issued, then the export or import character of the shipment may be shown by a contract or other written evidence showing the beginning point and ending point of air transportation. And Section 154.2-1(c)(1) of the Regulations is explicit in providing that transportation from a point outside the United States to a point inside the United States will not be considered broken "even though there may be stopovers in the United States (such as, for example, to consolidate cargo at a 'gateway' city)."

With regard to exports, the tax is not applicable to the segment of air transportation in the United States even though the mode of transportation in export is other than by air. Section 154.2-1(d)(1) of the Regulations provides:

> For example, the tax does not apply to air transportation from Chicago to New York if the property is in the course of exportation, by continuous movement, by boat from New York to Europe and in due course is so exported. Delays caused by circumstances beyond the control of the shipper (such as labor disputes or natural disasters) will not interrupt continuous movement. Property arriving at a gateway city by air may be repacked or consolidated with other property without interrupting continuous movement.

Under Section 154.2-1(d)(3) of the Regulations, payment of the tax may be deferred for six months to establish the fact of export "in due course" within that period. Proof of export received after six months will establish a ground for refund of the tax paid.

The foregoing provisions show that even when the facilities of the airways of the United States are employed,[8] Congress has exempted from the air transportation excise tax goods that are in fact imports and exports, and has provided flexible rules permitting stopovers, repackaging, and consolidation of cargo in the course of movement without loss of exemption. California's removal of property tax burdens upon imports and exports is therefore entirely consistent with congressional policy.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney

AUGUST 1979

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[8]Cf. *Massachusetts* v. *United States*, 435 U.S. 444 (1978).

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Brief of Amicus Curiae, Pioneer Electronics of America, Soundesign Western, Association of Electronic Importers, Foreign Trade Association of Southern California, in Support of Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

GERALD T. MANPEARL,
Los Angeles World Trade Center,
350 So. Figueroa Street, Suite 900,
Los Angeles, Calif. 90071,
Attorney for Amicus Curiae.

BAKER, ANCEL, REDMOND & HALL,
626 Wilshire Boulevard,
Los Angeles, Calif. 90017,
and
EVANS, MANPEARL & HARTER,
Los Angeles World Trade Center,
350 So. Figueroa Street, Suite 900,
Los Angeles, Calif. 90071,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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Brief of Amicus Curiae, Pioneer Electronics of America, Soundesign Western, Association of Electronic Importers, Foreign Trade Association of Southern California, in Support of Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

Interest of Amicus.

Pioneer Electronics of America, Soundesign Western, the Association of Electronic Importers, and the Foreign Trade Association of Southern California hereby respectfully file this Brief Amicus Curiae in Support of the Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District, filed herein by Sears, Roebuck & Co. The consent of the attorneys for Petitioner and for Respondents was obtained April 12, 1979, which letters of consent are respectively attached hereto as Exhibits "A" and "B."

Pioneer Electronics of America and Soundesign Western are domestic corporations importing goods into the State of California, a substantial portion of which is transshipped out of the State, and transshipment exemptions under California Revenue & Taxation Code Section 225 have been claimed, and such claims are pending before the County of Los Angeles and the courts of the State of California. These claims are dependent upon the outcome of this case.

Amicus Curiae Association of Electronic Importers is a California corporation consisting of electronic importers, all of whom have inventories in the State of California, transshipped a portion of such inventories out of the State, and fall within the provisions of Revenue & Taxation Code Section 225.

Amicus Curiae Foreign Trade Association of Southern California is a nonprofit association of more than 460 importing, exporting the service firms engaged in international trade and vitally interested in the impact and effect this litigation has had and will have on the importing industry and international trade. The members of the Association include more than 110 firms engaged in importing products from various countries throughout the world.

Attorneys for Amicus Curiae represent the above corporations and over 50 companies that have claimed transshipment exemptions under the provisions of California Revenue & Taxation Code Section 225 and have lawsuits pending against the County of Los Angeles for recovery of exemptions which have been denied. Said attorneys are familiar with all of the issues, briefs and facts in this case, represented Zee Toys, the companion case to *Sears, Roebuck & Co. v. County*

of Los Angeles, and can make a significant contribution to the Court's consideration of the Petition for Writ of Certiorari.

Amicus Curiae Pioneer Electronics of America and Soundesign Western are wholesalers, as distinguished from Petitioner Sears, Roebuck & Co., a retailer. To the extent such distinction is relevant, it is submitted that attorneys for Amicus Curiae can add to the consideration of the merits of this case.

Question Presented.

Whether California Revenue & Taxation Code Section 225, in granting a property tax exemption to imported inventories no longer in transit, but intended for transshipment out of the State of California, regulates interstate and foreign commerce and thereby violates the Commerce Clause of the United States Constitution.

Constitutional Provision Involved.

The constitutional provision involved is the Commerce Clause, Article I, Section 8, Clause 3 of the Constitution of the United States, which grants to Congress the right: "To regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes."

Statement of the Case.

In 1975 the California Legislature determined that an exemption for distributors, both retailers and wholesalers, was necessary in order to encourage importers presently located in the State of California to remain, and to encourage other importers to locate in the State.

The Legislature enacted Revenue & Taxation Code Sections 225 and 225.1, which provided in part, an exemption on that portion of business inventories that was imported from foreign countries and destined for transshipment out of the State of California. An importer was entitled to exempt that percentage of the imported inventories represented by the ratio of the previous year's total sales or shipments compared to his out-of-state sales or shipments. A copy of relevant sections is attached as Exhibit "C" hereto.

Petitioner Sears, Roebuck & Co., as well as Amicus, maintained warehouses in the County of Los Angeles during the relevant tax years in question, claiming exemptions under the provisions of Section 225 for that portion of their imported inventory which was intended for transshipment out of the State. The County denied the exemptions on the grounds that a warehousing operation did not come under the exemption provided by the statute. The County of Los Angeles took the position that only goods actually in transit on a continuous journey were entitled to the exemption. Subsequently, and during the course of litigation, the County of Los Angeles took the position that the transshipment exemption was unconstitutional. No evidence was introduced by the County relating to any impact which the statutes might have upon commerce between the states or foreign nations.

REASONS FOR GRANTING THE WRIT.

A. The Court of Appeal Has Decided a Federal Constitutional Question of Substance in a Manner Contrary to Applicable Decisions of This Court.

The Court of Appeal decision utilized a "per se" standard which would strike down any state statute differentiating between interstate and foreign commerce, no matter how reasonable the distinction. Such interpretation is in contrast to the modern trend of decisions allowing greater latitude to the states in instituting taxing policies.

In *Michelin Tire Corp. v. Wages,* 423 U.S. 276 (1976), this Court overruled *Low v. Austin,* 80 U.S. (13 Wall.) 29 (1872), holding that nondiscriminatory ad valorem property taxes did not constitute an impost or expost under Article I, Section 10, Clause 2 of the U.S. Constitution.

In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977), this Court overruled *Spector Motor Service v. O'Connor,* 340 U.S. 602 (1951), and held that a state, under appropriate conditions, may tax directly the privilege of conducting interstate business.

In *Washington Revenue Dept. v. Assoc. of Washington Stevedoring Companies,* 435 U.S. 734 (1978), this Court overruled *Puget Sound Stevedoring Co. v. Tax Commissioner,* 302 U.S. 90 (1937), and put to rest the direct/indirect test, and reiterated the necessity to balance the burden placed on interstate commerce by the benefits to the State. This Court stated: "Respondents, therefore, have demonstrated no impediment imposed by the tax upon the regulation of foreign trade by the United States." (435 U.S. 754).

In *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978), a single factor sales formula used to determine the amount of income tax attributable to the State was upheld. This Court pointed out that states have wide latitude in the selection of appropriate formulas which would only be disturbed in the event of clear evidence that the income attributed to the State was out of proportion to the business conducted.

In *Boston Stock Exchange v. State Tax Comm'r.,* 429 U.S. 318 (1977), this Court invalidated a New York tax scheme which was designed to provide a commercial advantage to local businesses (the New York Stock Exchange) to the detriment of out-of-state stock exchanges. The Court, however, cautioned:

> "On various occasions when called upon to make the delicate adjustment between the national interest and free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." (429 U.S. 329).

The statute involved in the instant case makes no distinction between out-of-state and in-state residents or businesses. On the contrary, both are given the economic advantage of utilizing the Free Port Law if their goods qualify. There was no evidence or finding of interference with commerce. The Court of Appeal assumed that any distinction had an effect on interstate commerce, and applied a "per se" standard on the grounds that any interference or potential interference constituted an impermissible burden under the Commerce Clause. This case therefore raises an important issue concerning the limitations imposed by the Commerce Clause on the power of a state to enact tax statutes to meet local needs.

The inventory in the instant case had come to rest in California, and was not still in transit for purposes of prohibiting taxation under the Commerce Clause. Such goods were therefore part of the mass of goods in the State of California, subject to ad valorem property taxes under *Michelin v. Wages, supra* and the State may require that they participate and bear their fair share of local services. However, unlike the issue in *Michelin v. Wages,* the question now is whether the State *must* tax such inventory together with all other inventory in the State.

This is the first instance Amicus have been able to find in which a state exemption statute has been struck down as placing an unconstitutional burden on interstate commerce. There was no attempt in the decision to determine whether the supposed burden was either substantial or unreasonable. (*Richfield Oil Corp. v. State Board of Equalization,* 329 U.S. 69 (1946).)

In holding Section 225 unconstitutional the Court of Appeal cited *Boston Stock Exchange v. State Tax Comm'r., supra,* and *Michelin Tire Corp. v. Wages, supra.* These cases are distinguishable, and do not support the Court's decision. To the extent that these cases have applied constitutional principles on a case-by-case basis, they are contrary to the "per se" ruling of unconstitutionality in the instant case.

B. Review by This Court Is Warranted to Resolve a Conflict Between State Court Decisions With Respect to the Constitutionality of "Free Port Laws."

It is common practice for states to encourage local industry by providing tax exemptions. Examples are domestic wines while aging in California, dairy products in Wisconsin, certain fish products in Louisiana, and wheat products in the Midwestern states. With increasing frequencies states have been providing exemptions to inventories, and especially inventories stored for transshipment. "Not only are inventories exempt in the few but very important states that exempt all personal property . . . but they are wholly or partially exempt in numerous other states and are almost universally exempt if they have been brought into a state for storage or other limited activities before being shipped out of the state." (National Tax Journal, Property Tax Developments: Modernization, Classification, Site Value Taxation, 19:322, 324 (Sept. 1976).)

Such classification statutes are tested under Equal Protection principles. In the instant case the California Court of Appeal conceded that if Los Angeles County were only invoking an Equal Protection argument, it could not prevail, since a rational basis existed for the distinction. (85 Cal.App.3d at 777).

Over 35 states have some type of free port exemption. A substantial number of these statutes grant out-of-state or foreign products an exemption which is denied to similar products manufactured or grown in the United States or in the state in question. These distinctions are based on the origin of the goods, the same distinction struck down in the instant case. An appendix of free port laws is attached as Exhibit "D" hereto.

Amicus knows of no other instance in which a free port statute has been held unconstitutional.

In *Appeal of Martin* (S.Ct. N.C., 1974) 209 S.E.2d 766, the Court upheld a statute providing the following exemptions:

1. Cotton, tobacco, other farm products, goods, wares and merchandise held for shipment to any foreign country or stored at a seaport awaiting further shipment *after being imported from a foreign country.*

2. Personal property of nonresidents in their original package shipped into the state and placed in a public warehouse for the purpose of transshipment to a destination either outside of the state or within the state.

3. Personal property of residents in their original package placed in a public warehouse for transshipment, but only to an out-of-state destination. (G.S. §105-281 (1969) Cum.Supp.)[1]

The statute discriminated based on the origin of the goods and based on the residence of the owner of the goods. The statute specifically described its purposes:

> "It is hereby declared to be the policy of this state to use its system of property taxation in such manner, through the classification of the aforementioned property, *as to encourage the development of the ports of North Carolina . . .* [and] *to encourage the development of the State of North Carolina as a distribution center.*" (Emphasis added.)

[1]Under this statute a distributor such as Petitioner or either individual amicus, who warehouse in non-public facilities would: (a) be taxed on goods purchased domestically; (b) be given an exemption on imported goods. This is the same distinction struck down in the instant case.

In *State Bd. of Tax Comm'rs. v. Carrier Corp.* (S.Ct. Ind., 1977) 365 N.E.2d 1385, ad valorem property tax exemptions were upheld under a statute almost identical to the one reviewed in *The Appeal of Martin.* In a Petition for Rehearing the Court held that the statute did not unreasonably burden interstate commerce. (*State Bd. of Tax Comm'rs. v. Carrier Corp.* (S.Ct. Ind., 1977) 365 N.E.2d 1153.)

If, in the instant case, the Court of Appeal has accurately interpreted *Boston Stock Exchange* and *Michelin Tire Corp.*, then both the North Carolina and Indiana taxing schemes would also have to fail for violating the Commerce Clause. Undoubtedly many of the other taxing schemes listed in Exhibit "D" would similarly fail the Court of Appeal's test.

In *Nash Sales v. City of Milwaukee* (S.Ct. Wisc., 1929) 224 N.W. 126, the State Legislature, concerned about the competitive position of its warehousing industry, granted an exemption to property manufactured or produced *outside* of the state, and in storage in Wisconsin. The Court held that there was no violation of the Commerce Clause, stating:

> " 'The discretion of the Legislature in this field is so broad that it is not competent for the court to mark the constitutional limitations of it other than at the farthest one might go without transcending all reason.' [citation]" (at 129.)

In *Allied Stores of Ohio v. Bowers,* 358 U.S. 522, 3 L.Ed.2d 480, 79 S.Ct. 437 (1959), an Ohio statute exempted merchandise belonging to nonresidents held in storage but taxed similar property belonging to residents. This Court upheld the statute against Equal Protection arguments.

In *Raley & Bros. v. Richardson,* 264 U.S. 157 (1924), this Court upheld a Georgia tax upon brokers or commission merchants dealing in intrastate goods, which tax was not imposed upon similar brokers dealing in goods in interstate commerce. This Court rejected arguments that such distinction violated the Commerce Clause.

Summary.

The shield of the Commerce Clause is generally sought by taxpayers attempting to prevent state and local taxation. Rarely if ever has such shield been successfully invoked by a taxing subdivision of the state to attack the state's own taxing scheme.

In *Boston Stock Exchange, supra,* this Court struck down, on Commerce Clause grounds, a New York taxing scheme providing benefits to residents, to the detriment of nonresidents. In *Allied Stores of Ohio, supra,* this Court upheld an Ohio statute providing a tax benefit to nonresidents to the exclusion of residents, attacked on the basis of Equal Protection.

In the instant case no distinction is made between residents and nonresidents; each are afforded the benefits of the transshipment exemption. The statute in question merely provides an exemption to one *type* of goods, to wit, goods which had been imported from abroad.

In *Japan Line, Ltd. v. County of Los Angeles,* ..... U.S. ..... (1979), this Court held that California property tax applied to foreign owned instrumentalities of international commerce prevented the Federal Government from speaking with one voice in international trade. In contrast, in the instant case the goods which are exempted have come to rest in California, are

part of the mass of goods located in the state, and are fully subject to the power of the state. (*Michelin Tire v. Wages, supra.*) The risk that foreign commerce will be burdened by the instant exemption is so remote that it can be said to be nonexistent. (*Bob-Lo Excursion Co. v. Michigan,* 33 U.S. 28 (1948).)

To allow the California Court of Appeal decision to stand would place in jeopardy free port or transshipment statutes throughout the nation, it would question every local statute attempting to encourage public policy or local economic goals by providing benefits to one type of activity or product while denying them to other activities or products. The decision is in conflict with the results and reasoning of *Michelin v. Wages, Complete Auto Transit, Inc. v. Brady, Washington Rev. Dept. v. Stevedoring Ass'n, Boston Stock Exchange v. State Tax Comm'r,* and *Raley & Bros. v. Richardson.*

Conclusion.

For the foregoing reasons the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

GERALD T. MANPEARL,
Attorney for Amicus Curiae.

BAKER, ANCEL, REDMOND & HALL,
and
EVANS, MANPEARL & HARTER,
Of Counsel.

EXHIBIT A.

Law Offices of
LOEB AND LOEB
One Wilshire Building
Sixteenth Floor
Wilshire Boulevard at Grand Avenue
Los Angeles, California 90017
(213) 629-0200 (213) 278-7351

April 12, 1979

Gerald T. Manpearl, Esq.
Evans, Manpearl & Harter
350 So. Figueroa St., Suite 900
Los Angeles, California 90071

Re: Sears, Roebuck & Co. v. County of Los Angeles (Zee Toys v. County of Los Angeles, 85 Cal.App.3d 763 (1978).)

Dear Mr. Manpearl:

This will confirm our telephone conversation of yesterday to the effect that we have no objection to your filing, by your firm and Baker, Ancel, Redmond & Hall, an Amicus Curiae Brief on behalf of the Petitioner Sears, Roebuck & Co. in support of the Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District, which Petition is being filed by our office with the United States Supreme Court.

Sincerely,

/s/ Frank M. Keesling
Frank M. Keesling
Of Loeb and Loeb

EXHIBIT B.

COUNTY OF LOS ANGELES
OFFICE OF THE COUNTY COUNSEL
648 Hall of Administration
Los Angeles, California 90012
John H. Larson, County Counsel

April 12, 1979

Gerald T. Manpearl, Esq.
Evans, Manpearl & Harter
350 So. Figueroa St., Suite 900
Los Angeles, California 90071

Re: Sears, Roebuck & Co. v. County of Los Angeles (Zee Toys v. County of Los Angeles, 85 Cal.App.3d 763 (1978).)

Dear Mr. Manpearl:

This will confirm our telephone conversation of yesterday to the effect that we have no objection to your filing, by your firm and Baker, Ancel, Redmond & Hall, an Amicus Curiae Brief on behalf of the Petitioner, Sears, Roebuck & Co., in support of the Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District, which Petition is being filed by Loeb and Loeb with the United States Supreme Court.

Very truly yours,
JOHN H. LARSON
County Counsel
/s/ By James Dexter Clark
JAMES DEXTER CLARK
Deputy County Counsel

EXHIBIT C.

[1]"Section 225. Personal property manufactured or produced (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

"Section 225.1 A person claiming an exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

"Section 225.2. Any property exempted under Section 225 which is reconsigned to a final destination in this state shall be subject to escape assessment procedures."

EXHIBIT D.

[1]The following statutes exempt goods shipped into and stored in the state from outside the state, awaiting shipment out of the state. Similar goods manufactured or produced in the state are not exempt: Ariz.Rev.Stat. §42-631; Iowa Code Ann. §427.16; La.Rev.Stat.Ann. 47:1951.3; Minn.Stat.Ann. §272.022; Mo.Rev. Stat. §137.093 (Vernon); Mont.Rev.CodesAnn. §84-202, Repl. Vol. 5 (Part 2); Nev.Rev.Stat. §361.160; 68 Okla.Stat.Ann. Tit. 68 §2425(e) (West); Or.Rev.Stat. §307.810; S.C. Code §12-1-50; Tenn.Code Ann. §67-518; and Tex. Tax Code Ann. Tit. 122, §7150(f) (Vernon's).

The following statutes exempt goods shipped into and stored in the state from outside the state, awaiting shipment either in or out of the state, as well as goods manufactured or produced in the state stored awaiting shipment out of the state. Similar goods manufactured or produced in the state stored awaiting shipment in the state are not exempt; Conn.Gen.Stat.Ann. §12-95(a); Ill.Stat.Ann. Ch.120, §500.21 (Smith-Hurd); Kan.Stat.Ann. §79-201(f); Ky.Rev.Stat. §132.-095; N.C.Gen.Stat. §105-275(10) (1977 Supp); and Wisc.Stat.Ann. §70.111 (West).

The following statutes exempt goods shipped into and stored in the state from outside the state awaiting shipment either in or out of the state. Similar goods manufactured or produced in the state are not exempt: Ind.Code. §6-1.1-10-29; and Mass.Gen.Laws Ann. Ch. 59, §2.

Ga.Code Ann. §92-186, 187, exempts goods originating in foreign countries stored in the port of entry in Georgia awaiting shipment outside of the state. Similar goods originating in Georgia or in other states stored in Georgia awaiting shipment out of the state are not exempt.

[2]See R&T Code §992, providing an exemption to wine and brandy in bond during the aging process, except for the first year. This exemption is only provided if the wine or brandy is produced or manufactured in California, and a similar exemption is not provided to imported wine or brandy. See, *e.g.*, R&T Code §232, providing an exemption to cargo containers used for transportation of cargo by vessels in ocean commerce. Unaffected are cargo containers used for rail, air or truck transportation; R&T Code §220, exempting aircraft brought into California for repair but not other aircraft in California which is being repaired.

Supreme Court, U. S.
FILED
NOV 15 1979
MICHAEL RODAK, JR., CLERK

APPENDIX

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,
Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

PETITION FOR CERTIORARI FILED APRIL 16, 1979.

CERTIORARI GRANTED OCTOBER 1, 1979.

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IN THE

Supreme Court of the United States

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COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

APPENDIX

RELEVANT DOCKET ENTRIES IN THE PROCEEDING BELOW
(Chronological List)

	Item	Date
1.	Complaint for Refund of Taxes Paid (Los Angeles Superior Court)	Filed February 25, 1977
2.	First Amended Answer (Los Angeles Superior Court)	Filed April 28, 1977
3.	Stipulation of Facts (Los Angeles Superior Court)	Filed January 23, 1978
4.	Notice of Motion for Summary Judgment (Los Angeles Superior Court)	Filed January 23, 1978
5.	Cross-Motion for Summary Judgment (Los Angeles Superior Court)	Filed January 24, 1978
6.	Hearing on Motion and Cross-Motion for Summary Judgment (Los Angeles Superior Court)	February 16, 1978
7.	Order and Judgment Granting Plaintiff's Motion for Summary Judgment and Denying Defendants' Cross-Motion for Summary Judgment (Los Angeles Superior Court)	Filed March 7, 1978 and Entered March 13, 1978
8.	Notice of Appeal (Los Angeles Superior Court)	Filed March 13, 1978
9.	Opinion of the Court of Appeal of the State of California, Second Appellate District, Division Three	Filed October 25, 1978
10.	Denial of Petition for Hearing in the Supreme Court of California	January 17, 1979
11.	Petition for Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District	Granted October 1, 1979

Complaint for Refund of Taxes Paid.

Superior Court of the State of California, for the County of Los Angeles.

Sears, Roebuck and Co., a corporation, Plaintiff, vs. County of Los Angeles, State of California, a body corporate and politic; City of Compton, State of California, a Municipal corporation, Does I-X, inclusive, Defendants. No. C191156.

Plaintiff alleges as follows:

FIRST CAUSE OF ACTION
(Against City of Compton
and County of Los Angeles)

1. At all times mentioned herein, plaintiff has been and now is a corporation duly organized and existing under and by virtue of the laws of the State of New York, qualified to transact business in the State of California, and having its principal place of business in California located in the County of Los Angeles.

2. At all times mentioned herein, defendant County of Los Angeles has been and now is a political subdivision of the State of California and a body politic and corporate having powers and authority to levy taxes.

3. At all times mentioned herein, defendant City of Compton has been and now is a municipal corporation located within the County of Los Angeles, organized and existing under a freeholder's charter pursuant to the constitution and laws of the State of California.

4. At all times mentioned herein, the City of Compton, pursuant to statute, has duly authorized the County of Los Angeles to act as an assessing and collecting agent for the assessment and collection of property taxes for the City of Compton, and at all times mentioned herein the County of Los Angeles through its qualified officers has duly acted in such capacity for and on behalf of the City of Compton.

5. The assessor of defendant County assessed to plaintiff for the tax fiscal year 1976-1977 certain personal property, being business inventory manufactured or produced outside of the United States and brought into California for transshipment out of said State for sale in the ordinary course of business. No portion of said personal property was in the manufacturing or production process.

6. In making said assessment, the assessor erroneously determined that the full cash value and assessed value of said property as of the lien date for said fiscal year, $4,724,738.00 and $1,181,184.50, respectively, were subject to taxation. In fact, all of said property was exempt from taxation by virtue of Revenue and Taxation Code Sections 225 and 225.1. Said erroneous assessment of plaintiff's property resulted in an excessive levy of taxes in the amount of $78,856.76. As of the lien date, all of said property was located at 615 West Walnut Street, Compton, California.

7. On or about August 30, 1976, plaintiff paid under protest the whole of said tax to the tax collector of defendant County, together with other taxes levied against plaintiff. A true and correct copy of said written protest is attached hereto, marked Exhibit "A" and incorporated herein by this reference as though set forth in full.

8. On September 13, 1976, plaintiff duly filed with the County of Los Angeles Assessment Appeals Board an Application for Equalization of 1976 Assessment, pursuant to the provisions of Revenue and Taxation Code, Division 1, Part 3. A true and correct copy

of said Application is attached hereto, marked Exhibit "B-8", and incorporated herein by this reference as though set forth in full. Said Application was heard by said Board on February 22, 1977, and was denied.

9. Said assessor, acting as aforesaid, has erroneously and mistakenly assessed and collected said taxes levied by defendant County in that said assessor improperly disregarded the exemption provided in Revenue and Taxation Code Sections 225 and 225.1. Said assessment and the denial of plaintiff's Application by the Assessment Appeals Board were arbitrary and capricious.

10. No refund of said taxes, or any part thereof, has been made to plaintiff or to anyone acting on its behalf.

SECOND CAUSE OF ACTION
(Against County of Los Angeles)

11. Plaintiff refers to Paragraphs 1-2, 5, 7, 9 and 10 of its First Cause of Action, and by this reference incorporates the same herein as though set forth in full.

12. In making said assessment, the assessor erroneously determined that the full cash value and assessed value of said property as of the lien date for said fiscal year, $2,931,760.00 and $732,940.00, respectively, were subject to taxation. In fact, all of said property was exempt from taxation by virtue of Revenue and Taxation Code Sections 225 and 225.1. Said erroneous assessment of plaintiff's property resulted in an excessive levy of taxes in the amount of $43,884.78. As of the lien date all of said property was located in an unincorporated area of the County of Los Angeles known as 19400 Laurel Park Road, Compton, California.

13. On September 13, 1976, plaintiff duly filed with the County of Los Angeles Assessment Appeals Board an Application for Equalization of 1976 Assessment, pursuant to the provisions of Revenue and Taxation Code, Division 1, Part 3. A true and correct copy of said Application is attached hereto, marked Exhibit "B-7", and incorporated herein by this reference as though set forth in full. Said Application was heared by said Board on February 22, 1977, and was denied.

THIRD CAUSE OF ACTION
(Against County of Los Angeles)

14. Plaintiff refers to Paragraphs 1-2, 4-5, 7, 9 and 10 of its First Cause of Action, and by this reference incorporates the same herein as though set forth in full.

15. In making said assessment, the assessor erroneously determined that the full cash value and assessed value of said property as of the lien date for said fiscal year, $7,266.00 and $1,816.50, respectively, were subject to taxation. In fact, all of said property was exempt from taxation by virtue of Revenue and Taxation Code Sections 225 and 225.1. Said erroneous assessment of plaintiff's property resulted in an excessive levy of taxes in the amount of $96.44. As of the lien date all of said property was located at 2834 Supply Avenue, Los Angeles, California.

16. On September 13, 1976, plaintiff duly filed with the County of Los Angeles Assessment Appeals Board an Application for Equalization of 1976 Assessment, pursuant to the provisions of Revenue and Taxation Code, Division 1, Part 3. A true and correct copy of said Application is attached hereto, marked Exhibit "B-6", and incorporated herein by this reference as though set forth in full. Said Application was heard by said Board on February 22, 1977, and was denied.

FOURTH CAUSE OF ACTION
(Against County of Los Angeles)

17. Plaintiff refers to Paragraphs 1-2, 4-5, 7, 9 and 10 of its First Cause of Action, and by this reference incorporates the same herein as though set forth in full.

18. In making said assessment, the assessor erroneously determined that the full cash value and assessed value of said property as of the lien date for said fiscal year, $11,709,325.00 and $2,927,331.25, respectively, were subject to taxation. In fact, all of said property was exempt from taxation by virtue of Revenue and Taxation Code Sections 225 and 225.1. Said erroneous assessment of plaintiff's property resulted in an excessive levy of taxes in the amount of $159,482.94. As of the lien date all of said property was located at 1430 South Eastman Avenue, Los Angeles, California.

19. On September 13, 1976, plaintiff duly filed with the County of Los Angeles Assessment Appeals Board an Application for Equalization of 1976 Assessment, pursuant to the provisions of Revenue and Taxation Code, Division 1, Part 3. A true and correct copy of said Application is attached hereto, marked Exhibit "B-1" through "B-5" and "B-9" through "B-25", and incorporated herein by this reference as though set forth in full. Said Application was heard by said Board on February 22. 1977 and was denied.

WHEREFORE, plaintiff prays for judgment as follows:

1. On its First Cause of Action, against defendants County of Los Angeles and City of Compton for a refund of $78,856.76;

2. On its Second, Third and Fourth Causes of Action, against defendant County of Los Angeles for a refund of $203,464.16;

3. On all causes of action, for interest, costs of suit and attorneys' fees; and

4. For such other and further relief as the Court deems just and proper.

DATED: February 25, 1977.

LOEB AND LOEB
/s/ Frank M. Keesling
Attorneys for Plaintiff

EXHIBITS TO COMPLAINT
HAVE BEEN DELETED

First Amended Answer to First Amended Complaint.

Superior Court of the State of California, for the County of Los Angeles.

Sears, Roebuck and Co., a corporation, Plaintiff, vs. County of Los Angeles, State of California, a body corporate and politic; City of Compton, State of California, a Municipal corporation, Does I-X, Inclusive, Defendants. No. C191156.

Defendants, COUNTY OF LOS ANGELES and CITY OF COMPTON, having filed their previous answer in error, supersede said answer with the following denials, admissions, and allegations:

1. Answering Paragraphs 1, 8, 10, 13, 16, and 19 of the complaint herein, defendants do not have information or belief sufficient to enable them to answer the allegations set forth therein and on that basis deny them.

2. Answering Paragraphs 2, 3, 4, and 7 of the complaint herein, defendants admit the allegations set for (*sic*) therein with the exception that the contents of the exhibit referred to are denied.

3. Answering Paragraphs 6, 9, 12, 15, and 18 of the complaint herein, defendants deny the allegations set forth therein with the exception of the alleged location of the goods which location is admitted.

4. Answering Paragraph 5 of the complaint herein, defendants admit that the assessor of defendant COUNTY assessed the plaintiff for the tax fiscal year 1976-77 certain personal property. Defendants deny that said property was brought into the State for the purpose of transshipment. Defendants do not have information or belief sufficient to enable them to answer the remaining allegations of said paragraph and on that basis deny them.

5. Answering Paragraphs 11, 14, and 17 of the complaint herein, defendants refer to their answers to the paragraphs set forth therein and incorporate said answers by reference.

BY WAY OF AFFIRMATIVE DEFENSES THE DEFENDANTS ALLEGE AS FOLLOWS:

6. That the plaintiff's complaint fails to state a cause of action;

7. That the plaintiff has failed to exhaust its administrative remedies;

8. That the Statute of Limitations (Revenue and Taxation Code Section 5138) has expired; and

9. That the plaintiff has based its complaint on legal theories which have not been embodied in any claim or letter of protest submitted to defendants.

WHEREFORE, defendants pray:

1. That plaintiff take nothing by its complaint herein;

2. That defendants be awarded their costs of suit; and

3. That defendants be awarded such other and further relief as the Court deems proper.

DATED: *April 28, 1977.*

JOHN H. LARSON, County Counsel
/s/ By James Dexter Clark
JAMES DEXTER CLARK
Deputy County Counsel
Attorneys for Defendants

Stipulation of Facts.

Superior Court of the State of California, for the County of Los Angeles.

Sears, Roebuck and Co., a corporation, Plaintiff, vs. County of Los Angeles, State of California, a body corporate and politic; City of Compton, State of California, a Municipal corporation. Does I-X, inclusive, Defendants. No. C 191 156.

Filed: January 23, 1978.

It is hereby stipulated by and between plaintiff, SEARS, ROEBUCK AND CO., a New York corporation, and defendants, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA and CITY OF COMPTON, STATE OF CALIFORNIA, through their respective attorneys of record, that for the purpose of determining the issues of law raised in this case the following facts are true, undisputed, and may be treated by the Court as facts proved in open court:

1. SEARS, ROEBUCK AND CO. ("Sears"), a New York Corporation, is an integrated company performing the functions of purchasing, importing, distributing, and selling goods at retail. Those goods which are the subject matter of this litigation are manufactured or produced outside of the United States (hereinafter "the goods"). They are purchased by the plaintiff and brought into California where they are held awaiting distribution to destinations both within and outside of the state, as described in paragraph 7 below. The goods are manufactured for the purpose of sale in the ordinary course of Sears' trade or business. No portion of the goods was in the manufacturing or production process at any time material hereto.

2. Sears retails its goods throughout the United States. Its distribution and retail facilities are in many locations, including Los Angeles County. Its corporate headquarters are located in Chicago, Illinois and most of the planning and purchasing functions are performed at that location.

3. Defendant County of Los Angeles is a charter political subdivision of the State of California, duly empowered to collect and levy ad valorem property taxes for itself and for certain municipal corporations, including the City of Compton.

4. During 1975, the Legislature of the State of California voted to enact legislation which is now codified as Sections 225 and 225.1 of the Revenue and Taxation Code. The Governor signed the bill (SB 389) and it became effective on January 1, 1976. A copy of SB 389 is attached, marked Exhibit "A", and made a part hereof as if fully set forth.

5. On March 1, 1976, Sears was holding certain personal property at various warehouses throughout the County, including a warehouse in the City of Compton. These warehouses were distribution warehouses. Subsequent to March 1, 1976, the goods in said distribution warehouses were forwarded to Sears' retail stores and catalogue distribution centers throughout the country. The distribution warehouses located in the County of Los Angeles were devoted almost entirely to the distribution of goods which were imported from foreign countries, particularly from locations in the Pacific area.

6. During the year preceding the lien date, Sears made out-of-state shipments and shipments within California of the goods, all as set forth in Exhibit "B", attached hereto and made a part hereof as if fully

set forth. Exhibit "B" also discloses the amount of Sears' imported goods on hand at the warehouses in Los Angeles County as of 12:01 a.m. on March 1, 1976.

7. (a) The distribution warehouses function as a distributor of all the goods imported by Sears into Los Angeles County.

(b) Other Sears' warehouses, not in the County of Los Angeles, are operated for the purpose of long-term storage. In contrast, the goods at issue in this case are meant to be shipped as quickly as distribution operations permit.

(c) The rate of turnover at the distribution warehouses averages approximately 3 times per year, with a range of 1½ times to 4½ times per year.

8. Virtually all of the goods arrived at the warehouses by means of shipment in cargo shipping containers ("sea vans"). After arrival at the warehouses, the goods were taken from the cargo shipping containers, and were held pending shipment to the Sears stores and catalogue distribution centers. While being held in the warehouses, the goods remained in the original cardboard boxes in which they were imported.

9. For the tax fiscal year 1976-77, the assessor of defendant Los Angeles County assessed to Sears an ad valorem personal property tax based upon all of the goods which are the subject matter of this action. Sears paid said tax under protest, claiming an exemption pursuant to Revenue and Taxation Code Sections 225 and 225.1, and thereafter duly exhausted its administrative remedies. No refund of any portion of said taxes was made to Sears, and this action was duly commenced.

10. The State Board of Equalization has promulgated a form for use in claiming exemptions under Revenue and Taxation Code Sections 225 and 225.1, a copy of which is attached hereto as the first page of Exhibit "C". The second page of Exhibit "C" (the reverse side of the form) consists of a form for use in claiming constitutional immunity for goods in transit in interstate or foreign commerce. The Los Angeles County Assessor has granted no exemption for the years 1976 or 1977 under Sections 225 or 225.1.

DATED: December 9, 1977.

LOEB AND LOEB
By /s/ Frank M. Keesling
Frank M. Keesling
Attorneys for Plaintiff

DATED: December 21, 1977.

JOHN H. LARSON,
County Counsel
JAMES DEXTER CLARK,
Deputy County Counsel
By /s/ James Dexter Clark
James Dexter Clark
Attorneys for Defendants

EXHIBIT A
Senate Bill No. 389
CHAPTER 1126

An act to add Sections 225, 225.1, and 225.2 to the Revenue and Taxation Code, relating to property taxation.

[Approved by Governor September 28, 1975.
Filed with Secretary of State September 28, 1975.]

LEGISLATIVE COUNSEL'S DIGEST

SB 389, Marks. Property taxation: exemption of property in transit.

Under existing law, tangible personal property having situs in California on March 1st is generally subject to property taxation. However, 50% of the assessed value of personal property constituting business inventories is exempt from taxation.

This bill would exempt in full personal property manufactured or produced outside California and brought into the state for transshipment in foreign commerce out of the state for sale. The bill would provide two methods of computing and claiming the exemption.

The bill would also provide that neither an appropriation is made nor an obligation created for the reimbursement by the state of any local agency for any revenue lost by it as a result of the exemption of property from taxation by this act.

The people of the State of California do enact as follows:

SECTION 1. Section 225 is added to the Revenue and Taxation Code, to read:

225. Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or

production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

SEC. 2. Section 225.1 is added to the Revenue and Taxation Code, to read:

225.1. A person claiming an exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

SEC. 3. Section 225.2 is added to the Revenue and Taxation Code, to read:

225.2. Any property exempted under Section 225 which is reconsigned to a final destination in this state shall be subject to escape assessment procedures.

SEC. 4. No appropriation is made by this act, nor is any obligation created thereby under Section 2229 of the Revenue and Taxation Code, for the reimbursement of any local agency for any revenue lost by it as a result of the exemption of property from taxation by this act because the net loss of revenues to any local agency is not significant.

EXHIBIT B.

SCHEDULE OF SHIPMENTS FROM CALIFORNIA WAREHOUSES

Department	California Shipments	Out-of-State Shipments	Total Shipments	Inventory as of March 1, 1976
1430 South Eastman Avenue				
601	50,367	380,091	430,458	142,873
603	1,478,837	4,494,427	5,973,264	2,474,658
604	90,980	164,677	255,657	85,863
606	1,127,526	1,290,064	2,417,590	1,340,701
607	747,102	4,355,370	5,102,472	4,169,945
620	4,691,344	2,937,071	7,628,415	1,531,832
621	438,453	223,257	661,710	136,756
622	1,156,182	604,208	1,760,390	667,174
624	199,790	407,368	607,158	333,370
627	829,329	264,791	1,094,120	819,204
629	1,065,396	3,892,509	4,957,905	2,009,070
634	391,216	434,315	825,531	843,346
637	8,783	66,380	75,163	38,398
640	243,864	1,108,940	1,352,804	255,441
642	24,738	11,544	36,282	53,434
649	204,238	316,438	520,676	260,831
657	12,323,076	6,165,506	18,488,582	2,813,246
664	50,362	27,066	77,428	19,436
671	189,480	237,439	426,919	92,343
677	692,824	1,288,235	1,981,059	910,279
688	95,630	62,042	157,672	163,393
615 West Walnut Street				
615	1,229,555	5,433,504	6,663,059	5,905,920
19400 Laurel Park Road				
615	762,953	3,371,554	4,134,507	3,664,694
2834 Supply Avenue				
611	23,410	70,229	93,639	29,060

EXHIBIT C.

EXEMPTION CLAIM FOR GOODS HELD FOR TRANSSHIPMENT

Name .....

Mailing Address .....

Location of Property .....

The cost of goods claimed to be exempt must be included in Line 20, Schedule A, AH 571-L (Business Property Statement—long form) or Line 2, Inventory Schedule, AH 571-S (Business Property Statement—short form) filed for this location.

This statement constitutes a claim for exemption from ad valorem tax on goods manufactured or produced outside this state and brought into this state for transshipment outside the United States or which were manufactured outside the United States and brought into this state for transshipment outside this state. Please answer the following questions:

1. Were the goods, for which the transshipment exemption is being claimed, at the above location as of 12:01 a.m., March 1, this year and were they manufactured or produced outside this state?

   Yes .....No .....

2. Were they held for transshipment to another state from outside the United States or for transshipment outside the United States from another state?

   Yes ..... No .....

3. Were the goods being claimed as exempt in this state for the purpose of manufacturing process or production?

   Yes ..... No .....

4. Total cost of goods claimed exempt under the transshipment exemption and held at this location as of 12:01 a.m., March 1, this year. (See instructions below.) Enter amount here and on Line 36, Schedule A, AH 571-L (Business Property Statement—long form) or Line 15, Inventory Schedule, AH 571-S (Business Property Statement—short form)

   $.....

INSTRUCTIONS

You may elect either of two methods to claim this exemption. See Section 225.1 of the Revenue and Taxation Code shown below.

Check which method you have elected:

I. Percentage;

II. Actual

Complete the following information for the method you have selected.

I. PERCENTAGE METHOD (List the following amounts at cost.)

   (a) Your total shipment of goods manufactured or produced outside of California and transshipped from this location out of the United States for the previous assessment year. (Assessment year is prior 12 months period March through February.)

   $.....

   (b) Your total shipment of goods manufactured or produced outside of the United States and trnasshipped from this location to another state for the previous assessment year.

   $.....

   (c) Total of Lines (a) and (b).

   $.....

   (d) Your total shipments of all goods from this location for the previous assessment year.

   $.....

   (e) Divide Line (c) by Line (d) and enter percentage here.

   .....%.

   (f) Total cost of all such goods at this location as of 12:01 a.m., March 1, this year.

   $.....

   (g) Multiply the percentage on Line (e) by the amount on Line (f) and enter the result on Line 4 above.

II. ACTUAL METHOD (Goods claimed exempt under the actual method must be supported by contracts of sale as of 12:01 a.m., March 1, this year. Attach sheets supplying the following information for goods claimed exempt.)

   a. Quantity and description of goods claimed exempt on Line 4 above.

   b. Total landed cost.

   c. Country or state of origin.

   d. Date goods received at this location.

e. Point of ultimate destination as evidenced by contracts of sale executed before 12:01 a.m., March 1, this year.

f. Date goods shipped to their ultimate destination.

g. Enter at Line 4 above the cost of goods claimed exempt under the actual method.

I declare under penalty of perjury that the foregoing information, including any accompanying schedules and statements, is true, correct, and complete.

Corporate or Owner's Name .....

By .....

Title .....

Date ....., 19.....

REVENUE AND TAXATION CODE SECTIONS

Sec. 225 Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

Sec. 225.1 A person claiming an exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allo-

cating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

Sec. 225.2 Any property exempted under Section 225 which is reconsigned to a final destination in this state shall be subject to escape assessment procedures.

IMMUNITY CLAIM FOR GOODS IN INTERSTATE OR FOREIGN COMMERCE

Name .....

Mailing Address.....

Location of Property .....

The cost of goods recorded but not on hand and claimed to be immune must be included in Line 20, Schedule A, AH 571-L (Business Property Statement—long form) or Line 2, Inventory Schedule, AH 571-S (Business Property Statement—short form) filed for this location. (Do NOT include in Line 20 or Line 2 nor is a claim form required if the goods are both not recorded and not on hand.)

This statement constitutes a claim for immunity on goods in transit in interstate or foreign commerce as of 12:01 a.m., March 1, this year. Please answer the following questions:

Part 1. GOODS IN TRANSIT FROM OTHER STATES OR COUNTRIES

a. The goods originated from another state or foreign country?

Yes ..... No .....

b. The goods were in the hands of a common carrier as of 12:01 a.m., March 1, this year?

Yes ..... No .....

c. Were the goods available for disposition as of 12:01 a.m., March 1, this year?

Yes ..... No .....

d. Are bills of lading or other documents which support this claim available on request?

Yes ..... No .....

e. Total cost of goods claimed immune is

$.....

Part 2. GOODS IN TRANSIT TO OTHER STATES OR COUNTRIES

a. The goods claimed to be immune were loaded aboard a ship or aircraft or were within the control of a carrier for continuous transportation to another state or country as of 12:01 a.m., March 1, this year?

Yes ..... No .....

b. Are bills of lading, dock receipts, foreign purchase orders, or other documents which support this claim available on request?

Yes ..... No .....

c. Total cost of goods claimed immune is

$.....

Enter here and on Line 35, Schedule A, AH 571-L (Business Property Statement—long form) or Line 14, Inventory Schedule, AH-571-S (Business Property Statement—short form) the total cost of goods claimed immune in Part 1 and Part 2 above.

$.....

I declare under penalty of perjury that the foregoing information, including any accompanying schedules and statements, is true, correct, and complete.

Corporate or Owner's Name .....

By .....

Title .....

Date ....., 19.....

Property is in transit in interstate or foreign commerce when it has been delivered to a carrier or, if delivery to destination is being made by the owner, when he has actually started transporting the property to its destination. Property is constructively received when it reaches its destination and is made available for disposition by the consignee of the shipment.

The interruption of transportation for purposes incident to transportation does not remove property from its in-transit status. The interruption of transportation for the business purpose or profit of the owner terminates the transportation and creates a situs for taxation at the place where the property is situated on the lien date.

Thus, property remains in transit if the interruption is caused by a breakdown in the transportation system

or equipment, the promotion of safe or convenient transit, or the accumulation by the carrier of sufficient cargo to make a load. On the other hand, property does not remain in transit if the interruption is for the purpose of further processing the goods, placing them in different containers, separating them for easier distribution to customers, storing them awaiting a favorable market, or any other purpose unconnected with transportation.

NOTE—Certain goods may be eligible for a transshipment exemption even though transit is interrupted. See the "Exemption Claim for Goods Held for Transshipment" on the reverse.

Notice of Motion for Summary Judgment; Declaration of Theodore F. Craver; Memorandum of Points and Authorities in Support of Motion.

Hearing Date: February 16, 1978
Time: 9:00 a.m.
Place: Dept. 47

Superior Court of the State of California, for the County of Los Angeles.

Sears, Roebuck and Co., a corporation, Plaintiff, vs. County of Los Angeles, et al., Defendants. No. C 191 156.

Filed: January 23, 1978.

TO THE DEFENDANTS AND TO THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on February 16, 1978, at 9:00 a.m., or as soon thereafter as the matter may be heard, in Department 47 of the above-entitled Court, located at 111 North Hill Street, Los Angeles, California, plaintiff Sears Roebuck & Co., will move said Court for summary judgment in favor of plaintiff and against all of said defendants.

Said motion will be made upon the grounds that there is no defense to the complaint herein, that no triable issue exists as to any material facts and that plaintiff is entitled to a judgment as a matter of law.

Said motion will be made and based upon this Notice, the Declaration and Memorandum of Points and Authorities served and filed concurrently herewith, upon the papers, pleadings and records on file herein, and upon such additional declarations that may be filed prior to the hearing hereon and upon such matters of which the Court may take judicial notice.

DATED: January 23, 1978.

LOEB AND LOEB
/s/ By Frank M. Keesling
Frank M. Keesling
Attorneys for Plaintiff

DECLARATION OF THEODORE F. CRAVER, JR.

I, THEODORE F. CRAVER, JR. declare:

1. I am, and for the past four years, have been employed by Security Pacific National Bank. For nearly four years I worked in the Research Department and had particular emphasis in international trade and foreign investment analysis. I am personally familiar with the facts set forth in this Declaration, and if called as a witness, I could competently testify thereto.

2. As a public service, Security Pacific National Bank in 1974 undertook a study and prepared a report entitled *Impact of the Ad Valorem Tax on Containerized Imports on the California Economy*. The study was thought to be necessary following the uncertainties which were created by differing interpretations of the decision by the California Supreme Court in the case entitled *Volkswagen Pacific, Inc. v. City of Los Angeles*. One of the basic purposes of the study was to determine the impact upon the California economy of the ad valorem property tax on containerized imports. The study was based upon an analysis of data obtained from (1) companies involved in importing, shipping, warehousing, and custom house brokers; (2) trucking firms, and (3) trade flows.

3. I was the individual in charge of the study, and based upon the data gathered and analyzed, I prepared the report dated April 30, 1975 entitled *Impact of the Ad Valorem Tax on Containerized Imports*

on the California Economy. A true and correct copy of the report of April 30, 1975 is attached and incorporated herein by this reference as though set forth in full.

4. Following the preparation of the report of April 30, 1975, I was invited to testify before the Senate Revenue & Taxation Committee. At the time I appeared, the Committee was holding hearings on proposals to create a "free port" in California for imported property destined to be sent outside California.

5. I testified, following the preparation of the April 30, 1975 report, before the Senate Revenue & Taxation Committee. In connection with my appearance before the Committee, there was distributed to each member a copy of the April 30, 1975 report, identical to the copy attached hereto. In addition, a copy of the report was distributed to each member of the Assembly Revenue & Taxation Committee. In addition to the distribution of the report to each member of the Revenue & Taxation Committee of both houses, copies were also distributed to various interested legislators who were not members of these committees.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 17th day of January, 1978 at Los Angeles, California.

/s/ Theodore F. Craver, Jr.
Theodore F. Craver, Jr.

IMPACT OF THE AD VALOREM TAX ON CONTAINERIZED IMPORTS ON THE CALIFORNIA ECONOMY

APRIL 30, 1975

BY
THEODORE F. CRAVER, JR.
INTERNATIONAL STUDIES SECTION

ECONOMIC RESEARCH DIVISION
RESEARCH DEPARTMENT
SECURITY PACIFIC NATIONAL BANK

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CALIFORNIA INTERNATIONAL TRADE STUDY

INTRODUCTION

International trade through California has been growing at an exceptionally rapid rate in the past ten years on both a value and a volume basis. Total trade in terms of value has increased 468 percent during this period, or at an average annual rate of 46.8 percent. While exports have grown 371 percent during this ten year period, imports have increased 571 percent. Also during this period, the trade balance for the state has reversed from a trade surplus of $119 million to a deficit of $3.3 billion. In 1974, imports accounted for 57.3 percent of the state's total trade, and exports accounted for the remaining 42.7 percent. Also, in 1974, California trade represented 11.5 percent of the total trade recorded for the United States (compared with 8.3 percent in 1965). At the same time, imports through California accounted for 13.1 percent and exports accounted for 9.9 percent of the nation's imports and exports.

While one can easily draw the conclusion that trade through California has grown tremendously in the past decade, it is important to view this growth in relation to other measures of California's economic growth. One such measure that can be used for illustrative purposes is personal income. During the past ten years personal income in the state has increased 108 percent (compared with a 486 percent growth in total trade during the same period), from $60.1 billion to $124.9 billion. Though it is difficult to make direct comparisons between trade and personal income, it is interesting to note the following "share" of personal income represented by international trade.

INTERNATIONAL TRADE AS A PERCENTAGE OF PERSONAL INCOME

Year	Imports	Exports	Total Trade
1965	3.5%	3.3%	6.8%
1974	10.5%	7.8%	18.3%

The degree of economic impact from imports has steadily increased along with its share of California's total trade. The recognition of this impact has generated increased concern over the possibly unfair tax advantages that importers may possess over domestic manufacturers. Certain proponents of the ad valorem tax on containerized imports have stated that the tax was, in part, imposed so as to reduce these purported advantages held by importers.

DESCRIPTION OF THE TAX

As a result of a California Supreme Court ruling (*Volkswagen Pacific, Inc. v. City of Los Angeles,* 7 Cal 3d 48), certain county tax assessors have removed the immunity of the contents of incoming sea-van containers from the state's ad valorem inventory tax. The

previous interpretation of the "original package doctrine" was that goods from a foreign country are not subject to state and local taxation while they remain unsold and in the original, unbroken package (*Article I, Section 10, Clause 2, U.S. Constitution*). However, the assessing officials now have stated that a shipping (air and sea-van) container is the "original package", and once the container is opened, the goods inside are subject to assessment for inventory tax purposes.

The tax is assessed as of March 1 every year. The inventory tax is based on the assessed value of the merchandise, which is 25 percent of one half of the true market value of the goods. The tax rate levied varies from county to county and even within a particular county. Depending on the location of a business within a county, the tax rate per $100 of assessed value ranges from $7.00 to $16.50 in Alameda County and $9.00 to $13.00 in Los Angeles County. (The average rate in Los Angeles County is $12.00. Thus, for example, a tax of $150.00 would be paid for an opened container valued at $10,000.00.)

Numerous claims have been made by affected firms stating that the tax is an arbitrary one, since a shipment of goods imported by container is taxed, whereas if that same shipment of goods had been imported break-bulk it would not be subject to the tax. The California State Board of Equalization, as called for in Senate Concurrent Resolution Number 154, reviewed the legal issues and found that, "The sea-van itself is not an "original package" as a matter of law. If imported goods contained therein are packaged in a manner that has customarily been used in world commerce for the type of goods concerned, an opening of the

van will not destroy immunity from property taxation." However, the legal battle is expected to continue for some time into the future, since certain County Tax Assessors state that the State Board of Equalization has no authority to rule on the constitutionality of federal law. Numerous lawsuits against the counties levying the tax are pending at this time. Recently, Montgomery Ward & Co. won its case against Alameda County, but the Alameda County Tax Assessor's office stated that it will appeal all the way to the U.S. Supreme Court, if necessary.

In a special report to the Senate Select Committee on Maritime Industry entitled "Ad Valorem Tax on Containerized Cargo" the following list of countries and revenues collected from the tax was presented. As stated in that report, the source of the list was a June 19, 1974, memorandum from Mr. Ronald B. Welch, of the State Board of Equalization, to the Assembly Committee on Revenue and Taxation.

County	Revenues
Alameda	$ 868,750
Contra Costa	100,000
Los Angeles	9,000,000
Monterey	3,500
San Francisco	172,000
San Luis Obispo	0
San Mateo	379,000
Santa Barbara	3,000
Santa Cruz	0
Solano	0
Ventura	0
Total	$10,526,323*

*Santa Clara County had not yet responded to the inquiry at the time of this memorandum, and subsequently our committee has been informed that Sacramento County has begun to tax imports. An up-dated list will be provided our committee by the Board of Equalization next month.

As the legal issues have worked their way through the court system, the economic issues have been largely ignored. The primary reason for this lack of attention is the absence of data on the impact of the inventory tax on international business in California and on the state's economy.

PURPOSES AND OBJECTIVES OF THE STUDY

The primary purposes of the California International Trade Study are twofold. First, the report attempts to assess the economic and financial strength of importing businesses and of some of the major service industries associated with the import business (such as warehouses and customs house brokers). Second, the study attempts to determine the scope of the impact of the ad valorem tax on the importing business. In this regard, the basic objectives were to:

(1) Quantify wherever possible, the economic impact of the tax.

(2) Explore those areas in the economy that are affected by the tax.

(3) Determine the present and explain the major factors influencing future impact of the tax.

The study is based on the analysis of data obtained from three basic gathering tools:

(1) *Importing, warehousing, shipping companies, and customs house brokers*—The data gathering tool was a five page questionnaire. The objective of the questionnaire was to determine which firms are affected by the tax, to what degree, and how.

(2) *Trucking firms*—Again, the data gathering tool was a five page questionnaire. The objective of the questionnaire was to determine if trucking

firms have been affected by the tax and to describe the extent and pattern of the diversion of goods, if any. (The assumption involved in this case was that, if a diversion of goods from California ports to other "free ports" was occurring, the traditional trucking patterns would be disrupted and the trucking firms would be aware of those disruptions and why they occurred.)

(3) *Trade flows* (interstate and intrastate)—The primary tool for this analysis was Security Pacific Bank's International Trade Databank. The analysis was performed on a per commodity basis, in an attempt to determine which commodities are imported by container and, of those, which have experienced diversion to free port areas to avoid the tax.

As a final note, Security Pacific Bank's Research Department is of the opinion that, while international trade in California is increasing tremendously, the amount and quality of statistical and analytical support have not kept pace. This study is an attempt to reduce this gap by offering research and analysis as a public service to assist both policy-makers and businesses in resolving certain issues relating to international trade that ultimately affect the people of California.

FIRMS AFFECTED

THE QUESTIONNAIRES

The questions in the importers/warehouses and the trucking companies questionnaires were designed to obtain the following information.

(1) The problems that have the most effect on the international business community.

(2) The present and future financial and economic condition of the international business community, in terms of employment and sales.

(3) Current plans of those companies involved in international trade for *expansion* of their facilities in California.

(4) Current plans of those companies involved in international trade in California for *relocating* any part or all of their facilities to another state.

(5) The costs of conducting business in California compared with other states.

(6) Awareness of the ad valorem tax among internationally related companies.

(7) Whether international trade related companies are diverting any of their goods or business to "free port" areas to avoid the inventory tax.

(8) Whether companies currently (or are planning to) divide up their business, so that goods bound for California consumption are handled by a California branch, and goods bound for out-of-state consumption are handled through a free port area.

(9) The affect that the ad valorem tax has had on the international trade related companies' plans for doing business in 1975.

(10) The inflationary impact of the tax.

(11) The type of goods imported and the type of goods subject to the ad valorem tax.

(12) The percentage of goods, on an average annual basis, that are imported by container, and the growth of imports in 1975 shipped by container.

METHODOLOGY

In the importer/warehouser/shipping company/ customs house broker sample, a questionnaire was mailed to the California based companies listed in the *1974/1975 California International Business Directory* that were either importers or importers/exporters. Those companies listed in the directory as solely exporters were excluded from the sample. In addition, California-based-warehousers, shipping companies and customs house brokers found in the Dun and Bradstreet Company directory were included.

In the trucking company sample, a different questionnaire was mailed to a select sample of California based trucking companies found in the Dun and Bradstreet Company directory. Only those companies listed as long range carriers were considered.

A total of 271 questionnaires from the importer/ warehouser, shipping company/customs house broker sample, and a total of 94 questionnaires from the trucking companies sample, were completed and returned for editing, coding, keypunching, and tabulation. Chi Square analysis was performed on the samples which determined that they adequately represented the entire population of importers, warehousers, customs house brokers and trucking firms and that no significant variations occurred between the demographic characteristics of the samples and the populations.

To ensure that the mail questionnaire had been completed by the person in the company best able to supply accurate information, all respondents were asked to include their titles. The following table demonstrates that the questionnaire was completed by the appropriate persons:

Who Completed Questionnaire:	Importer, Warehouser, Shipping Company, Customs House Broker Sample	Trucking Firms Sample
OWNER/PARTNER	14%	24%
PRESIDENT	40%	53%
VICE-PRESIDENT	20%	11%
SECRETARY-TREASURER	7%	3%
MANAGER/ GENERAL MANAGER/ SALES MANAGER	14%	6%
ACCOUNTANT/ CONTROLLER	5%	3%
	100%	100%

COMPANY ANALYSIS

Sales Volume—Import firms tend to have lower dollar sales volume than warehousing and import manufacturing firms. Among importers, the larger the firm's sales volume, the more likely it is to use containers.

Effect of the Ad Valorem Tax on Containerized Cargo Imports—Among those firms using containers for imported goods, the ad valorem tax was considered to be one of the major problems facing international businesses in California today. In addition, the ad valorem tax was more frequently mentioned as a problem among those companies that import less than 50 percent of their goods by container—this is perhaps the inverse of what might be expected. Also, manufacturing firms that use imported goods in their operation and import these goods by container are less affected by the tax, compared with importing firms and warehouses.

Those firms that are affected by the ad valorem tax are either changing their operations or making plans to do so, by diverting goods to free port areas, relocating part of their facilities out of California,

or dividing their overland common point (OCP) goods from their goods bound for California consumption.

Firms that conduct between 10 and 50 percent of their total sales volume in California are changing their operations more than those firms conducting more than 50 percent of their total sales volume in California. Among the firms affected by the tax, manufacturing firms are the only firms not changing their operations. Those "container" firms affected by the tax and relocating part of their facilities out-of-state are also diverting cargo and dividing OCP goods for California consumption goods.

Expansion—More "container" firms than "noncontainer" firms are *not* expanding. Firms that feel the tax has affected their business are not expanding their facilities in California. Those firms that do not feel the tax has affected them are moe likely to have expansion plans in California. This difference becomes more pronounced as sales volume increases and is particularly true of warehousing firms. Smaller "noncontainer" firms are more likely to be expanding their facilities while large "container" firms are less likely to be expanding.

Relocation of Facilities Out of State—The relocation of part of all of a firm's facilities out-of-state is occurring more often among "container" firms than "noncontainer" firms. Among those firms relocating because of the tax, importers are the most prevalent. A higher percentage of those firms that feel affected by the tax are relocating, compared with those firms that do not feel affected by the tax and that have a pessimistic outlook for 1975 are relocating. Among "container" firms, those that feel affected by the tax are more

likely to be relocating than other "container" firms. Also, those firms that perceive that the cost of doing business in California is increasing, relative to other states, and "container" firms with between 10 and 50 percent of their sales volume in California are likely to be relocating.

Diverson of Goods—Import firms using containers are the most *likely* to be diverting goods. Also, the larger the share of total goods imported by container, the larger the percentage of goods diverted.

1974 Versus 1973 Performance and the 1975 Outlook—More "container" firms than "noncontainer" firms stated that they fared worse or the same in 1974 versus 1973. Likewise, more "container" firms than "noncontainer" firms have a pessimistic outlook for 1975. Firms that feel affected by the ad valorem tax performed worse in 1974 and have a pessimistic outlook for 1975 than those firms that do not feel affected by the tax. In fact, it is twice as likely that firm that feels affected will be pessimistic about 1975.

A pessimistic 1975 outlook among those firms affected by the tax is more likely the greater their total sales volume. Among those firms affected by the tax, importers tend to be much more pessimistic in their outlook for 1975 than warehousers. Finally, among all firms that feel the cost of doing business in California has increased relative to other states, the firms that are affected by the tax have a more pessimistic outlook for 1975 than those firms not affected by the tax.

SUMMARY OF RESPONSES TO SELECTED QUESTIONS FROM THE TRUCKING FIRMS QUESTIONNAIRE

Between eight and nine percent of the total respondents stated that the inventory tax was one of the three most important problems facing international business today. Among those trucking firms aware of the tax, 24.1 percent viewed the tax as one of the top three problems.

Thirty-one percent of the trucking firms were aware of the ad valorem tax on containerized imports. Among those companies providing in excess of $1 million of services there was a 38 percent awareness.

Twenty percent of the total respondents stated that portion of their business had been diverted to the "free port" areas to avoid certain counties in California imposing a tax on containerized imports. Among those firms aware of the tax, 41 percent responded that portions of their business had been diverted.

Thirteen percent of the total respondents estimated that up to 30 percent of their business had been diverted. Among those firms that have noticed a diversion of their business to "free port" areas, 63 percent estimated the amount of diversion to be up to 30 percent of their business.

Eleven percent of the total respondents stated that the tax on containerized imports has affected their plans for doing business in 1975, and among those firms aware of the tax, 28 percent said their business plans for 1975 had been affected.

Seventeen percent of the total respondents indicated an awareness of an increase in the transport of goods from "free port" areas into California. Among those

firms that have experienced a diversion of their business, 68 percent noticed an increase.

All three groups of firms listed in the paragraph above indicated that the majority of the increase in shipments of goods from the "free ports" into California was between 10 and 30 percent.

IMPACT OF THE AD VALOREM TAX ON THE CALIFORNIA ECONOMY

The study was designed to determine the economic impact of the ad valorem tax on containerized imports. In this effort, we developed ten questions to obtain the data necessary to make an economic evaluation of the tax. Our findings are presented in terms of those questions below.

(1) *Is the tax viewed as an important business problem by international businesses?*

Thirteen percent of the importers and seventeen percent of the warehousers polled viewed the tax as a leading problem. By applying these percentages to the total number of importers and warehousers in California, it would appear that approximately 150 to 200 importers and 225 to 275 warehousers view the tax as a leading problem.

The top three problems cited by the firms—(1) rising transportation costs/ocean freight rates; (2) Inflation, (3) Recession/lack of demand—are all economically caused problems. Importantly, the fourth most troublesome problem—the ad valorem tax on containerized imports—is the major non-economically caused problem.

(2) *Did the tax adversely affect the 1974 business performance of the companies?*

The questionnaire asked the firms to state whether their 1974 business performance was better, worse, or about the same as their 1973 performance. Then they were asked to state the *primary* reason for their 1974 performance. From the data obtained, it appears that the tax was not the *primary* cause for a comparatively poor 1974 business performance (only two companies cited the tax as the primary reason for their company's difficulties which is statistically insignificant in terms of the total sample). However, it is highly probable that the ad valorem tax was considered a secondary factor in the relatively poor performances, especially among the 15 percent citing "higher expenses" as the primary cause.

(3) *Is the tax expected to affect the 1975 business performance adversely, as viewed by the companies?*

Again, as in the question above, the questionnaire asked the firms for the *primary* reason why the companies expected their 1975 performance, when compared to 1974, to be better, worse, or about the same. From the data collected, it appears that the tax is expected to be insignificant in its effect on the companies anticipating a poor 1975 performance. Two companies expected the tax to have a damaging effect on their 1975 performance, which is statistically insignificant in terms of the total sample. Again, however, it is probable that the tax is considered to be a

secondary factor among those firms anticipating a poor performance in 1975, especially among the 13 percent responding that "negative governmental interference" was the primary reason for the expected poor performance.

(4) *Is the tax affecting business plans and operations?*

Almost one quarter of the companies polled stated that the tax has affected their plans for doing business in 1975. Among importers and warehousers, the proportion was even higher, indeed almost one-third. The primary responses as to how the tax was affecting their business plans were, in order of importance (1) reducing inventories in the months preceeding the March 1st tax date; (2) channeling business through other ports; (3) changing the packaging to get around the tax; and (4) increasing prices to cover the tax expense.

(5) *Is the tax affecting the planned growth of facilities?*

The data shows that the tax is the *primary* reason for not expanding the facilities in California of a small percentage of the companies polled (5 percent of the warehousers and 2 percent of the importers). However, it should be pointed out that in the questionnaire only the *main* reason for expanding or not expanding was asked. Therefore, it is probable that the tax was one of the lesser reasons for not expanding and hence is affecting the planned growth of California facilities more than is shown in the data.

(6) *Is the tax causing companies to relocate part or all of their facilities out of California?*

The data shows that 23 percent of the companies planning to relocate part or all of their facilities out of California are doing so because of the tax. However, only the primary cause for a relocation was solicited in the questionnaire, and it is probable that the tax was one of the secondary causes—especially among the 15 percent that responded that "California taxes" in general were the reason for their moving.

(7) *Is the tax causing a more rapid increase in the cost of doing business in California relative to other states?*

Eight percent of the companies felt that the tax was the primary reason for a more rapid increase in the cost of doing business in California relative to other states. It is probable that more firms felt that the tax was a secondary cause for the relative increase, especially among the 23 percent that stated "higher taxes" in general was the primary cause.

(8) *Is the tax contributing to the rise in prices paid by the consumer?*

The assumption in this question is that the business currently paying the tax can either absorb the cost of the tax, pass it on, or do a little of each. The data from the questionnaire shows that almost 60 percent of the companies are passing the cost on to the consumer, 20 percent are absorbing the cost, and the remaining 20 percent said the question did not apply to them. Importers were more likely to pass the cost on to consumers,

while more warehousers were inclined to absorb the cost.

(9) *Is the tax causing a diversion of goods from California to "free port" areas?*

Of all companies polled, 10 percent indicated that they were diverting goods due to the tax. However, a more meaningful measure is among those firms involved with containerized imports, among whom 14 percent have been diverting their goods. Based on the percentage of firms diverting goods in the study group, it is estimated that 145 California-based importers and 195 California-based warehousers are diverting some of their goods.

Although it is important to attempt to determine the *number* of firms *currently* diverting goods, it is equally important to attempt to estimate the *dollar* amount of goods that is currently being diverted. However, this is a substantially more difficult quality to estimate. By taking the data from the questionnaire pertaining to average annual sales, cross-tabulating these values with the percent of goods diverted, and the making assumptions on the average gross margins realized by the different types of importing and warehousing firms, an estimate was made of the 1974 dollar amount of goods diverted by the firms in the sample. Based on this approach it is estimated that $16,168,700 was diverted by firms in the sample in 1974. By taking this figure and applying it to the total universe of California-based importers and warehousers, it is estimated that total imports of $211.4 million were diverted in 1974. It is important to emphasize that the universe

used to estimate this dollar amount and to derive the sample was only California-based companies and, hence, does not represent the total number of importers and warehousers that are involved in the importation of goods through California ports of entry. Indeed, based on figures presented in the "1972 Census of Wholesale Trade", published by the U.S. Department of Commerce, it was determined that the California-based importers represented 54.9 percent of the total imports flowing through California ports of entry. It would be misleading to attempt to apply this percentage to the $211.4 million figure presented above in an effort to determine the total dollar amount of goods diverted by both California-based and non-California based importers and warehousers because the sample did not represent non-California-based companies. However, it is highly probable that some portion of the non-California-based companies did divert some percentage of the goods, hence increasing the total impact of the tax.

(10) *Is the tax reducing the amount of "Overland Common Point" goods brought in through California?*

Based on the data from the questionnaires, the most severe impact of the tax was directed at OCP goods. Thirteen percent of the companies stated that they are currently dividing up their business to have goods bound for California consumption imported by a California branch and OCP goods imported through a "free" port. Two thirds of those companies cited the tax as the primary reason for doing so. Notably, of those companies *not* currently dividing their imports,

16 percent are planning to do so—85 percent of whom are doing so primarily because of the tax.

Again, it should be emphasized that the sample included only California-based companies. It is highly probable that non-California-based companies would also be dividing goods for California consumption from OCP goods. Indeed, it is probable that non-California-based companies would have greater flexibility to divide OCP goods from California consumption goods, and hence contribute a more pronounced effect on the loss of OCP traffic.

In terms of its impact on the California economy, the loss of OCP traffic due to the ad valorem tax on containerized imports is probably the most severe. One reason for this impact is that over the years, California has developed as the major West Coast distribution center for the entire United States. Thus, by definition, the loss of OCP traffic results in the deterioration of California's industries involved in the nationwide distribution of goods. Furthermore, OCP goods represent a much different impact on the California economy from imports that are consumed in California in terms of their effect on employment and income. Imports that are consumed in California actually act as competition to locally manufactured goods and hence have a net negative impact on employment and income. OCP goods, however, are, by definition, not consumed in California and hence do not act as direct competition to locally produced goods. Indeed, they contribute employment and income, since they must be han-

dled, comingled, processed, and shipped to other states. Thus, since the tax is decreasing OCP traffic through California, it is ultimately decreasing employment and income in the state, as well.

CONCLUSION

Analysis of the data shows that the ad valorem tax on containerized imports has had a definite impact on the California economy. Some of the reactions by the affected firms have shown that the tax has disturbed their usual (pretax) operations. Some of these reactions include a reduction of inventory in the months immediately preceding the March 1 lien date and an attempt to import more goods breakbulk or by palate instead of by container. While these actions very likely produce inventory flow problems, and to a lesser degree cash flow problems, their overall adverse impact on the California economy is probably very slight. However, the data show that the tax has spawned certain more severe reactions. The most disturbing of these are (1) relocations of part or all of business facilities out of California, (2) the hindering of the expansion of facilities within California, (3) an inflationary impact, (4) the diversion of goods from California ports, and (5) the loss of OCP trade from California ports. All of these effects have a negative impact on employment and real income.

This study is an attempt to quantify what the impact of the tax has been on the California economy. It should be noted that the study has addressed itself to certain economic issues relating to the tax and should not be interpreted to have represented either all the firms involved or all of the possible impacts of the tax on the California economy. Also, the study

has attempted to assess the past and current impact of the tax and has not dealt completely with the future impact of the tax. However, the firms that have the greatest potential to be affected by the tax and the most important economic issues have been studied in this report, and analysis of the data has shown that there has been a significant negative impact on trade flows and on the operations of international businesses.

Cross-Motion for Summary Judgment.

Memorandum of Points and Authorities.

Date: February 16, 1978
Time: 9:00 A.M.
Dept: 47

Superior Court of California, County of Los Angeles.

Sears Roebuck & Co., a corporation, Plaintiff, v. County of Los Angeles, etc., et al., Defendants. Case No. C 191156.

TO THE PLAINTIFF AND ITS ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on February 16, 1978, at 9:00 A.M. or as soon thereafter as the matter can be heard, in Department 47 of the above-entitled court, located at 111 North Hill Street, Los Angeles, California, the defendants COUNTY OF LOS ANGELES and CITY OF LOS ANGELES will move that the motion of plaintiff be denied and that the court grant a summary judgment against the plaintiff.

Said Cross-Motion for Summary Judgment will be made upon the grounds that there is no cause of action maintainable by the plaintiff which it states in its complaint, and that defendants are entitled to a judgment as a matter of law.

Said motion will be based upon this notice, the attached memorandum of points and authorities, all papers, pleadings and records filed herein, such additional declarations and affidavits that may be filed prior to or at the hearing hereon, such matters that the court may take judicial notice of, and such other evidence, oral or documentary, as may be presented

to or filed with the court prior to or at the hearing hereon.

DATED: January 24, 1978

Respectfully submitted,
JOHN H. LARSON
County Counsel
by /s/ James Dexter Clark
JAMES DEXTER CLARK
Deputy County Counsel
Attorneys for Defendant
COUNTY OF LOS ANGELES

Order Granting Plaintiff's Motion for Summary Judgment and Denying Defendants' Cross-Motion for Summary Judgment.

Superior Court of the State of California, for the County of Los Angeles.

Sears, Roebuck and Co., a corporation, Plaintiff, vs. County of Los Angeles, State of California, a body corporate and politic; City of Compton, State of California, a Municipal corporation, Does I-X, inclusive, Defendants. No. C 191 156.

Filed: March 7, 1978.

The Motion of plaintiff, Sears, Roebuck and Co., for Summary Judgment, and the Cross-Motion of defendants, County of Los Angeles and City of Compton, for Summary Judgment, came on regularly to be heard before the Honorable Campbell M. Lucas, Judge presiding, in Department 47 of the above-entitled Court, on February 16, 1978, at 9:45 a.m.; Loeb and Loeb by Andrew S. Garb, Frank M. Keesling and Terry L. Polley, appeared for plaintiff; John H. Larson, County Counsel, by James Dexter Clark, Deputy County Counsel, appeared for defendants.

After reading and considering all of the memoranda filed in support of said Motions and in opposition thereto, the documentary evidence attached to said memoranda, the Declaration filed in support of plaintiff's Motion, and the Stipulation of Facts entered into by the parties and filed herein on January 23, 1978, and after hearing oral argument, it is hereby

ORDERED, ADJUDGED AND DECREED as follows:

1. There is no triable issue as to any material fact, the parties having stipulated to, and the Court

having adopted, all of the facts necessary to determine the issues of law raised herein;

2. Pursuant to the relevant provisions of Section 225 of the Revenue and Taxation Code, personal property is exempt from ad valorem property taxation if it is manufactured or produced outside of the United States and brought into this state, for transshipment out of the state for sale in the ordinary course of trade or business;

3. Based upon the Stipulated Facts, the Court has concluded that the personal property which is the subject matter of this action, and which was held by plaintiff in distribution warehouses pending shipment to its retail stores and catalogue distribution centers, was manufactured or produced outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of plaintiff's business;

4. Sections 225 and 225.1 of the Revenue and Taxation Code are constitutional under the United States and California Constitutions, as said Sections have been construed herein, and as applied to the facts of this case;

5. This Court has concluded that the California Legislature intended under Sections 225 and 225.1 of the Revenue and Taxation Code to exempt the personal property such as that held by plaintiff at its distribution warehouses in Los Angeles County pending shipment to plaintiff's retail stores and catalogue distribution centers outside of California;

6. Accordingly, this Court has concluded that plaintiff is entitled to the exemption provided in Revenue and Taxation Code, Section 225, and is entitled to compute the aforesaid exemption under the percentage

method provided in Revenue and Taxation Code, Section 225.1;

7. Plaintiff is therefore entitled to a refund of the taxes paid under protest for the fiscal year 1976-77 from the County of Los Angeles and the City of Compton in the amount of $80,381.58, and from the County of Los Angeles in the additional amount of $204,142.13, plus interest thereon commencing August 30, 1976, pursuant to Revenue and Taxation Code, Sections 5141 and 5150; and

8. There being no defense to plaintiff's action, and plaintiff being entitled to judgment as a matter of law, plaintiff's Motion for Summary Judgment is granted, defendants' Cross-Motion for Summary Judgment is denied, and the Clerk is directed to enter Judgment accordingly.

DATED: March 7, 1978.

CAMPBELL M. LUCAS
Judge of the Superior Court

Supreme Court, U. S.
FILED
MAY 16 1979
MICHAEL RODAK, JR., CLERK

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1978
No. 78-1577

SEARS ROEBUCK AND CO.,
a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES and
CITY OF COMPTON,

Respondents.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI

JOHN H. LARSON
County Counsel

JAMES DEXTER CLARK
Deputy County Counsel

648 Hall of Administration
Los Angeles, California 90012
(213) 974-1833

Attorneys for Respondents

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Attorneys for Respondents

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IN THE
SUPREME COURT
OF THE UNITED STATES
October Term 1978
No. 78-1577

SEARS ROEBUCK AND CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,

Respondents.

RESPONSE TO PETITION FOR WRIT OF CERTIORARI

The opinion below and the grounds upon which Petitioner relies for jurisdiction are fully set forth in the Petition for Writ of Certiorari.

QUESTIONS PRESENTED

The Respondents believe that a failure to understand the impact of Revenue and Taxation Code §225 has resulted in an inaccurate

statement of the questions presented by Petitioner.

In the first question, the statute is described as "valid when enacted." This is not necessarily true since §225 actually immimized goods whose original packages were opened. Goods being repackaged would be exempt under the statute if they were sold to an out-of-state customer. But they definitely had no immunity under Low v. Austin, 80 U.S. (13 Wall.) 29 (1872). Thus the state-mandated favortism for foreign goods resulted from the statute even before Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976) was handed down by this Court, although not to the same extent as afterwards.

The questions presented should therefore read:

1. Is a state exemption expanding a constitutional immunity to be deemed constitutional on the basis of the immunity alone, and does the situation change when the immunity is made totally inapplicable to the situation?

2. Is a state capable of distinguishing between types of interstate commerce in an attempt to induce a retention, or increase, of business within its borders?

3. In striking down a statute because it invades a power given to Congress, must a court have evidence of discrimination between businesses?

The statute involved is attached to the Petition as Appendix "B." Revenue and Taxation Code §253.10, relied on by the court below for its interpretation of the exemption is attached hereto as Appendix "A."

STATEMENT OF THE CASE

The Petitioner's statement of the case appears to contain some statements which are open to question.

The statute's purpose was clearly not to resolve the question of taxation of containerized imports. That issue was resolved just 13 days before the California governor's signing of §225, when he signed Revenue and Taxation Code §233 entitled "GOODS IMPORTED IN CONTAINERS." (See Appendix "B".)

Thus, there are only two possible conclusions to reach regarding §225; it was meant to exempt goods (1) when they were being repackaged and (2) when they were in transit.

It is also clear that those exports which were coming from other states could also receive favored treatment under §225, since exports were not subject to the original package concept (see Empressa Siderurgica v. County of Merced, 337 U.S. 154, 155-157, 93 L.Ed. 1276, 69 S.Ct. 995 (1949)).

The Petitioner also indicates that Respondents believed that the statute was being incorrectly interpreted by taxpayers but did not specifically raise the idea that the statute was unconstitutional. As indicated by the Respondents' briefs below, the unconstitutionality of the importers' interpretation has always been one principle reason for differing with that interpretation. In any case, the Petitioner's claim is not followed by any proposed result, and one must assume that the Petitioner brings it up here for its psychological effect on this Court.

THE REASONS FOR GRANTING THE WRIT SUBMITTED BY PETITIONER ARE INADEQUATE

Obviously, the Petitioner is relying on the importance of the issue as its ground for urging this Court to grant the Writ of Certiorari. But in doing so, the Petitioner has overstated the case. Implicit in the Petitioner's remarks are the ideas (1) that Allied Stores of Ohio v. Bowers, 358 U.S. 522, 3 L.Ed.2d 480, 79 S.Ct. 437 (1959) is contrary to the opinion below, and (2) that all of the states' "further shipment" exemptions are in jeopardy.

(1) There is no doubt that the broad issue of whether a state can discriminate between competitors and competing goods is important. It is briefly discussed, infra. But although one can read that issue into the opinion below,

it is not taken up there.

(2) Although other states' "further shipment" exemptions do discriminate against manufacturers having facilities within their borders, neither the Petitioner nor the fellow taxpayer in the companion case, Zee Toys, Inc. v. County of Los Angeles, pointed out one such statute which actually redefines the adjustment Congress has made between foreign and other states' goods. Revenue and Taxation Code §225 is unique in this respect.

As a result, the Petitioner's argument, resting, as it must, on the alleged far-reaching effect of this case, does not support its claim for a hearing by this Court.

There is a further reason for denying the Writ. Those interested in retaining the exemption have sponsored the introduction of a bill in the California Legislature which would substantially alter Revenue and Taxation Code §225. The same benefit would be given to foreign goods, but would also extend to all other goods manufactured in other states. Thus, the discrimination would be between (a) interstate commerce in foreign and non-California goods on the one hand, and (b) interstate commerce in California goods on the other. Although the respondents believe that the new statute is invalid for the same reasons as the old one, it would appear that the Legislature may eliminate the future impact of the former wording. A copy of the proposed legislation is attached

hereto as Appendix "C."

THE OPINION BELOW IS CORRECT

Although the opinion below restricted its discussion to the narrow issue of discriminatory treatment of domestic commerce as opposed to foreign commerce, the broader issue of the ability of the States to regulate commerce when they regulate their economies is present. But Congress' regulation of competition generally, as well as foreign competition in particular, is complete. Attempts to create exemptions for one business or a group of businesses, and not for its competitors, in order to alter patterns of interstate commerce are simply not appropriate.

A. CONGRESSIONAL CONTROL OF COMPETITION

The Petitioner seeks the advantage of a statute which, when enacted, would allow it 3½% pricing leeway in reduced costs as compared with companies selling U.S. products. It has been held by this Court, as well as by Congressional legislation that,

> "Price is the 'central nervous system of the economy.' United States v. Socony-Vacuum Oil Co., 310 U.S. 150, 226 n. 59, 84 L.Ed.

> 1129, 60 S.Ct. 811, and an agreement that 'interfere[s] with the setting of price by free market forces' is illegal on its face. United States v. Container Corp., 393 U.S. 333, 337, 21 L.Ed.2d 526, 89 S.Ct. 510." Nat'l Soc. of Professional Engineers v. U.S., 435 U.S. 679, 55 L.Ed.2d 637, 650, 98 S.Ct. 1355 (1978)(emphasis added).

And further that,

> "The heart of our national economic policy long has been faith in the value of competition." (Standard Oil Co. v. Federal Trade Commission, 340 U.S. 231, 248, 95 L.Ed. 239, 71 S.Ct. 240 (1951).

Yet the Petitioner claims that it may have this advantage over competing goods and that it is proper for a State to give it to it. It suggests that an effort to control interstate and foreign commerce so as to create a flow of goods through the State is a proper reason for operating contrary to the general economic rule of equality (see Adam Smith, Wealth of Nations (London 1776), Book V, Ch. II, Part 2 and Lindholm, Public Finance and Fiscal Policy (New York, 1950) p. 274). But interference with such Congressional authority will create the spectre of 50 different economic regulatory systems which are free to change the balance set by Congress. The Federal Government cannot operate effectively under a system which, instead

of leaving the powers of each level of government intact and complete, constitutionally allows the states to counteract the effect of economic regulations of the Federal Government.

This case presents a prime example of that sort of "system."

B. FEDERAL CONTROL OF THE FOREIGN-DOMESTIC DICHOTOMY

The Tariff Act of 1930 (19 U.S.C. §§1202, et seq.) sets up a whole structure of value-added taxes designed to protect American industry and gather federal revenues (see Isaacs, Business, Government and Public Policy, Princeton, N.J. 1964, pp. 380, et seq.). The Tariff Act of 1974 (19 U.S.C. §§2101, et seq.) also serves an "equalizing" purpose, putting foreign industry, with varying cost factors, on an even level with American industry.

As was pointed out below, the tools given to the President, to adjust the level of foreign prices have been utilized (see Appellants' Opening Brief below, Exhibit B and The Wall Street Journal, March 29, 1978).

The Petitioner seeks to re-adjust the Tariff Acts so as to achieve an effective 3½% reduction in the alignment of foreign and domestic goods prescribed by Congress. (The tax rate for the year in question was approximately 3 to 3½%.)

As this Court is aware, it is the Respondents' position that once foreign enterprises are allowed to operate in this country, the States should not differentiate between them and domestic enterprises (see Respondents' Brief in Japan Line Ltd v. County of Los Angeles, 77-1378). The states should not add to or take away from the privilege allowed by Congress. But the conditions upon which entry is made are particularly within the competence of the Federal Government and the states may not add or take away from them by adding regulations of its own (see Hines v. Davidowitz, 312 U.S. 52, 85 L.Ed. 581, 61 S.Ct. 399 (1941) and De Canas v. Bica, 424 U.S. 351, 47 L.Ed.2d 43, 96 S.Ct. 933 (1976)).

It may be argued that this Court altered that rule in its decision in Japan Line Ltd v. County of Los Angeles, No. 77-1378 (1979). It may be argued that, since an automatic preference for certain foreign-originating property is now constitutionally mandated, Rev. & Tax Code §225 is simply another similar mandate and is valid as a result. Of couse, the difference is that the States themselves have no inherent power to treat foreign and domestic enterprises differently as that would be contrary to the ability of the national government to "speak with one voice" (Japan Lines, supra, Slip Opin. at p. 15-17). Also see Bethlehem Steel Corp. v. Dept. of Water and Power, 276 Cal.App.2d 221, 80 Cal.Rptr. 800 (1969) hrg. den.

The Federal Government has determined the conditions upon which foreign goods will enter this country. By discriminating between foreign and United States goods (or between some foreign goods and some United States goods), Revenue and Taxation Code §225 counteracts the effect of the carefully drawn tariffs established by Congress and the President.

C. A STATUTE BASED UPON A CONSTITUTIONAL IMMUNITY MUST STILL BE CONSTITUTIONAL

The Petitioner argues that, first, that §225 conforms to Low v. Austin, supra, and, second, because of that, the section still retains validity after that case was overruled.

Even assuming that Rev. & Tax Code §225 did conform to Low v. Austin, supra, there is no logical reason to assume that the States may individually retain constitutional immunities by means of statute, if those immunities, as interpreted, violate other constitutional principles. In other words, the Low v. Austin concept is no longer a part of the constitution. It is no longer entitled to the same deference as it was when it was thought to be actually a part of the Constitution. That concept must pass muster like any other state statute, and although entitled to deference, it is not to be treated as equal to other constitutional provisions, but subordinate to them.

The Petitioner's argument on this point runs into other logical flaws. It contends that because the statute was enacted before the change in constitutional interpretation, it should automatically continue in effect. This sort of discrimination against interstate commerce could then continue indefinitely, but only in those states previously practicing it. Such a rule would simply abrogate the authority of the Constitution itself, contrary to the Supremecy Clause (Art. VI, Cl. 2).

This Court has recently inquired into the retroactive impact of its decisions which overrule former constitutional interpretations (see Baytagh, Ten Years of Non-Retroactivity: A Critique and Proposal, 61 Va. L. Rev. 1557 (1975)). Implicit in this Court's decisions on this point is the idea that overruling decisions do change the law. Petitioner argues that the change does not occur if a state has enacted a statute conforming to the former rule. It is difficult to conceive of a concept more inimical to the rights of the people than this one. Changes in criminal and civil rights would be impossible under such a system.

It bears pointing out once again that the Petitioner's proposal would simply stop all constitutional inquiry into a statute originally conforming to an earlier interpretation of a constitutional provision.

D. WHETHER THE STATE HAS DISCRIMINATED AGAINST ANY PARTICULAR ENTERPRISE IS NOT RELEVANT TO THE QUESTION OF THE EXISTENCE OF ITS POWERS

The Petitioner suggests that some showing must be made that a state regulation of commerce actually puts an enterprise at a disadvantage before a court can say that the state regulation exceeds that state's powers.

The Respondents' response, and the Appellate Court's opinion, do not rest on anything so temporary. They deal with the power of Congress to regulate interstate and foreign commerce and a state's action which does that which Congress is empowered to do.

There is no question that the commerce clause (Art. I, §8, Cl. 3) does not eclipse the power of the states to levy taxes. But it does limit their ability to use their taxing power so as to regulate commerce (Boston Stock Exchange v. State Tax Commission, 429 U.S. 318, 50 L. Ed. 2d 514, 97 S. Ct. 599 (1977).

It is not the effect on one enterprise or another which is the test of whether a state has regulated beyond its power, but the effect on Congress' power. Revenue and Taxation Code §225 reduces the effect of Congressional tariffs. That is the question. If the statute is

allowed to stand because no showing was made in this case that Sears' televisions were put in an advantageous position compared to some other companies, Congress' power to regulate the difference between foreign and domestic goods would still be less because of the statute.

This Court has already rejected the idea that discrimination makes any difference when considering a State's power to tax (Japan Line Ltd v. County of Los Angeles, supra, Slip Opin. p. 22).

E. THE 3% DIFFERENTIAL IS NOT INSIGNIFICANT

The Petitioner claims that the opinion of the court below requires meticulous equality between types of interstate commerce. But the 3-3½% rate of tax in effect between 1976 and 1978 cannot be viewed as insignificant. For the goods taxed, the 3% differential corresponds exactly to the annual shifts in tariffs on CB radios imposed by the President pursuant to the Tariff Act of 1974 (see Wall Street Journal of March 29, 1978, supra).

In fact, equality is required of the States. The commerce clause does not prohibit state taxation, but it does prohibit state regulation of commerce, particularly where the same kind of regulation has already been completely undertaken by Congress. The States have no power to adjust the tariff schedule made by Congress and the President.

In retaining uniformity of treatment of the various sorts of commerce, the Court of Appeal has retained the ability of the Federal Government to differentiate, i.e., to regulate. It is when the States are permitted to benefit one form of commerce at the expense of another that Congress is forced to consider the States' forms of taxation. If the States retain uniformity, Congress can regulate, knowing that the distinctions it creates will have their full impact.

Respectfully submitted,

JOHN H. LARSON
County Counsel

JAMES DEXTER CLARK
Deputy County Counsel

Attorneys for Respondents

§ 253.10 Method of claiming transshipment exemption

A person claiming the transshipment exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an actual method as evidenced by contracts of sale in existence on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

Transshipment exemption claimants shall submit to the assessor annually an affidavit, giving any information required by the board.

(Added by Stats.1977, c. 246, p. —, § 7.)

Derivation: Former § 225.1, added by Stats.1975, c. 1126, p. 2746, § 2.

Library References
Taxation ⇨101.
C.J.S. Taxation §§ 115, 120.

Asterisks * * * indicate deletions by amendment

§ 233. Exemptions; imports from foreign countries; opening containers; effect

(a) For the purpose of taxation of goods imported from foreign countries in containers the opening of such containers shall not necessarily, in itself, result in the loss of immunity for such goods to which it is entitled * * * under the United States Constitution.

(b) The immunity from taxation of goods imported from foreign countries shall not be lost when a container is opened for the following purposes:

(1) To inspect the contents of such container.

(2) To remove the goods belonging to two or more importers for delivery to them.

(3) To remove the goods solely for storage by the importer.

(4) To remove the goods to divert them to separate outlets of the importer in interior states.

(c) The circumstances in which opening a container shall not result in the loss of immunity from taxation is not limited to the list contained in subdivision (b).

(d) For the purposes of this section, the term "containers" is defined in Section 232.

(Added by Stats.1975, c. 748, p. 1747, § 1. Amended by Stats.1977, c. 246, p. —, § 5.)

APPENDIX "C"

SENATE BILL No. 940

Introduced by Senator Marks

March 27, 1979

An act to repeal and add Section 225 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

SB 940, as introduced, Marks. Property taxation: goods in commerce.

Under the existing Constitution of the United States, the states are prohibited, without the consent of Congress, from laying any imports or duties on imports or exports, except as may be absolutely necessary for executing their inspection laws. The Supreme Court of the United States, in Brown v. Maryland, 6 L.Ed. 419, held, in effect, that such prohibition precluded the imposition of state excise taxes on importers while goods remained in their "original package," and such court, in Low v. Austin, 20 L.Ed. 517, later extended the "original package" doctrine to grant immunity to imported goods in their original packages from ad valorem property taxes. On January 14, 1976, the Supreme Court of the United States overruled Low v. Austin and held, in Michelin Tire Corporation v. Wages, 46 L.Ed. 2d 495, that the imposition of nondiscriminatory property taxes on imports are not precluded by the Import-Export Clause of the Constitution of the United States.

Prior to the adoption of the Michelin case, in Chapter 1125 of the Statutes of 1975, the Legislature, pursuant to the independent power granted to it to classify and exempt personal property for purposes of property taxation by Section 2 of Article XIII of the California Constitution, added Section 225 to the Revenue and Taxation Code to exempt certain property in foreign commerce, whether or not such property remained in the original package. In Zee Toys, Inc.,

v. County of Los Angeles, 85 Cal.App.3d 763, on October 25, 1978, the California Court of Appeals held Section 225 to be an invalid attempt to regulate interstate and foreign commerce by the selective exemption for goods in foreign trade, while granting no such exemption for goods in interstate commerce.

This bill proposes to grant the same exemption as the one before the court in the Zee Toys case, except that such exemption would apply to goods in both foreign and interstate commerce.

The bill would also require the State Controller to report to the Legislature on the amount of claims made by county auditors for reimbursement for property tax revenues lost by reason of the exemption of property as proposed by the bill.

Vote: ⅔. Appropriation: no. Fiscal committee: yes. State-mandated local program: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 225 of the Revenue and Taxation Code is repealed.

~~225. Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.~~

SEC. 2. Section 225 is added to the Revenue and Taxation Code, to read:

225. Personal property manufactured or produced outside this state and brought into this state for transshipment outside the state for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption provided for in this section shall not apply to personal property in the manufacturing process or in

production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

SEC. 3. The State Controller shall report to the Legislature on the amount of the claims made by county auditors under Section 16113 of the Government Code for compensation for property tax revenues lost by reason of the exemption of property by this act. Such report shall be made on or before the first day of October next following the operative date of this act, in order that the Legislature may appropriate funds for the subventions required by Section 2229 of the Revenue and Taxation Code.

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1978
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,

Respondents.

Reply to Response to Petition for Writ of Certiorari.

HOWARD I. FRIEDMAN,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorney for Petitioner.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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Respondents for the First Time Advance Arguments Which, if Upheld, Would Invalidate the "Free Port" Laws of Many States 1

Appendix A. Commerce Clearing House List of States With "Free Port" Laws and an Analysis of the Provisions Thereof.

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IN THE

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Reply to Response to Petition for Writ of Certiorari.

Respondents for the First Time Advance Arguments Which, if Upheld, Would Invalidate the "Free Port" Laws of Many States.

Some 37 states have enacted "free port" laws. Many of such laws grant an exemption for goods brought into the state from other states and foreign countries for shipment outside the state. A similar exemption in many cases is not accorded to goods produced in the state and subsequently shipped outside the state. See Appendix A for a Commerce Clearing House list of states with "free port" laws and an analysis of the provisions thereof.

In their Response to the Petition for Certiorari, respondents for the first time make clear their position, which, if upheld, would require that the "free port" laws described above be held invalid. In at least two ways respondents' position places the validity of such laws in jeopardy.

First, in the third paragraph on page 5 of their Response, attention is called to a bill introduced in the California Legislature which would extend the exemption to goods brought into the state from other states for shipment outside the state. Goods produced in the state would remain taxable even though shipped outside the state. Respondents categorically state that "* * * the new statute is invalid for the *same reasons* as the old one * * *." (Emphasis added.) If the proposed legislation would be invalid, as respondents maintain, then similar "free port" laws of numerous other states must also be invalid.

Finally, respondents' argument that the statute involved herein is invalid on the grounds that it interferes with Congressional power to levy tariffs is equally applicable to the "free port" laws of many other states. For example, X Company manufactures television sets in Oregon, most of which are shipped to other states for sale therein. Under Oregon's "free port" laws such locally produced merchandise is not exempt from Oregon's personal property tax. A competitor of X imports television sets manufactured in Japan which are stored in Oregon for subsequent shipment to other states. Such sets are exempt from the Oregon tax under its "free port" law. Assuming that the Oregon tax rate is 3½% (which respondents erroneously state is the rate in California*), then the goods imported into Oregon enjoy a 3½% advantage not accorded

*On page 8 of the Response it is stated that the tax rate for the year in question (1976) was approximately 3 to 3½%. However, California Revenue and Taxation Code, Sec. 319 provides for a 50% exemption for business inventories. This has the effect of reducing the tax rate to one-half of the rates stated in the Response, i.e., to 1½ to 1¾%. Furthermore, this rate is applied only to the goods actually in the state on March 1st, the state's tax date. Considering the normal "turnover rate" of petitioner's inventory, the effective rate of tax which should be used to determine the benefit of the exemption accorded certain imported goods may be as little as ½% or less rather than the 3 to 3½% as stated in the Response.

Even if Congress should endeavor to take varying state tax rates into account in fixing tariffs, which it never has done and probably never will do, an exemption from a tax of ½% or less is too insignificant to justify a difference in applicable tariffs.

to the goods locally produced in Oregon. If, as respondents insist, the California statute at issue here is invalid on the grounds that it interferes with Congressional power to levy tariffs, then the Oregon statute and similar statutes of numerous other states must be equally invalid.

Thus, the issue involved herein is not confined to the validity or invalidity of a California statute exempting certain imported goods. Instead, the grounds upon which respondents and the Court below rely to invalidate the California statute must inexorably lead to the conclusion that the "free port" laws of many other states are invalid as well. This indeed is a serious issue.

We respectfully urge the Court to grant the Petition for Writ of Certiorari and to set the fears of invalidity at rest.

Respectfully submitted,

HOWARD I. FRIEDMAN,
Attorney for Petitioner.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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JUST PASSING THROUGH

Thirty-seven states and the District of Columbia now have "free port" laws designed to eliminate the possibility of double taxation of property stored in one state before shipment to another state. Generally these laws provide that no property tax will be assessed against tangible personal property which is shipped into the state and stored in a warehouse while awaiting further shipment to a destination outside the state.

In the absence of such laws, persons engaged in selling and shipping goods across state lines would be faced not only with the possibility of multi-state income and sales taxes, but also with the possibility of multistate property taxes.

It should be noted that some states provide specific exemptions from personal property taxes which are exclusive of the free port exemption.

For a summary of free port law requirements in each state, see the table below.

Chart of State Free Port Law Requirements

State	Must Goods Be Shipped in from Out of State	Must Storage Facility Be Public	Are Consignor or Consignee Prohibited from Owning Storage Area	Must Goods Be Destined for Out of State	Must Final Destination Be Specified	Must Goods Remain in Original Packages
Ala.[11]	No	No	No	Yes	Yes[9]	No
Ariz.	Yes	No	No	Yes	Yes[6]	No
Ark.	No	No	No	Yes	No[8]	No
Calif.	Yes[12]	No	No	Yes[12]	No	No
Colo.[8]	No	No	No	Yes	No	No
Conn.	No	Yes	Yes	No[1]	No	Yes
D. C.	No	Yes	No	Yes	No	No
Fla.	Yes	No	No	Yes	No	No
Ga.[10]	Yes	No	No	Yes	No	No
Ida.	No[4]	No	No	Yes	No[6]	No[4]
Ill.	No	Yes	Yes	No[1]	Yes	Yes
Ind.	Yes	Yes	Yes	Yes	Yes	Yes
Iowa	Yes	No	No	Yes	Yes[9]	No
Kan.	No	No	No	Yes	No[7]	No
Ky.[5]	No	Yes	Yes	No[1]	Yes	Yes

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State Free Port Law Requirements—Continued

State	Must Goods Be Shipped in from Out of State	Must Storage Facility Be Public	Are Consignor or Consignee Prohibited from Owning Storage Area	Must Goods Be Destined for Out of State	Must Final Destination Be Specified	Must Goods Remain in Original Packages
La.	Yes	No	No	Yes	Yes[8]	No
Me.	No	No	No	Yes	Yes	No
Mass.	Yes	Yes	Yes	No	No	Yes
Mich.[31]	No	Yes	Yes	Yes	Yes	No
Minn.	No	No[34]	Yes	Yes	No	Yes
Miss.	No	No	No	Yes	Yes[9]	No
Mo.	Yes	No	No	Yes	No[8]	No
Mont.	Yes	No	No	Yes	No	No
Neb.	No	No[14]	No	Yes	No	No
Nev.	Yes	No	No	Yes	Yes[9]	No
N. J.	No	No	No	No	No	No
N. M.	Yes	No	No	Yes	Yes[9]	No
N. C.	No[3]	Yes	Yes	No[3]	No	Yes
Ohio	Yes	No	No	Yes	No	No
Okla.	Yes	No	No	Yes	Yes[8]	No
Ore.	Yes	No	No	Yes	No[7]	No
S. C.	Yes	No	No	No	Yes[9]	No
S. D.[35]	No	No	No	Yes	No.[8]	No
Tenn.	Yes	No	No	Yes	Yes[9]	No
Tex.[36]	Yes	No	No	Yes	No	No
Utah	No	No	No	Yes	No	No
Wis.	No	No	Yes	No[1]	No	Yes
Wyo.	No	No	Yes	Yes	No[7]	No

[1] Only the property of residents must be destined for out-of-state shipment.
[2] Subject to a tax of 1½¢ on each $100 of fair cash value, in lieu of all other taxes.
[3] Property not destined for out of state must have been shipped in from outside the state.
[4] Personal property designated for reshipment outside of Idaho need not be stored in the original package. Property of a nonresident must be stored in the original package and must be shipped in from out of state.
[5] Assessed at 5% of actual value.
[6] Final destination must be specified by warehouse if known.
[7] Final destination must be specified by warehouse.
[8] If required to determine in-transit character.
[9] The exemption is granted property in transit whether the final destination was specified when transportation began or afterwards.
[10] Georgia provisions apply to property imported into the United States by waterborne commerce through any Georgia port. The provisions do not apply except to situs for taxation by political subdivisions of Georgia in which the port of original entry is located.
[11] Valid for not over 36 months following consignment or storage of the property.
[12] Only personalty shipped into California for transshipment outside the U. S. or shipped into California from outside the U. S. for transshipment outside California is exempt.
[13] Alcoholic beverages excepted.
[14] Warehouses must be licensed and regulated by the state.
[15] Must be shipped to final destination within 12 months of assessment date.
[16] May not be detained more than 9 months.

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On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

BRIEF FOR THE PETITIONER.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,
Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

BRIEF FOR THE PETITIONER.

Opinions Below.

The order of the trial court is not officially reported. The opinion of the Court of Appeal (Pet. App. 1-29)[1] is reported at 85 Cal.App.3d 763, 149 Cal.Rptr. 750 (1978). The denial by the Supreme Court of California of a petition for hearing (Pet. 2) is reported at 149 Cal.Rptr. 764 (1979).

[1]The Appendix attached to the Petition for Certiorari shall be referred to as "Pet. App." followed by the appropriate page numbers. The separate Appendix required by Rule 36 shall be referred to as "A." followed by page numbers. The Petition for Certiorari shall be referred to as "Pet." followed by page numbers.

Jurisdiction.

The decision of the Court of Appeal was filed on October 25, 1978 (Pet. 2; Pet. App. 1). The Supreme Court of California denied a petition for hearing on January 17, 1979 (Pet. 2). The petition for a writ of certiorari was filed on April 16, 1979. The petition was granted on October 1, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

Question Presented.

Does a California statute exempting from its property tax certain goods manufactured or produced outside the United States and imported into California for shipment outside the state violate the Commerce Clause of the United States Constitution?

Constitutional Provisions and Statutes Involved.

1. Article I, Section 8, Clause 3 of the United States Constitution provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

2. Article I, Section 10, Clause 2 of the United States Constitution provides: "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws; * * *"

3. Amendment XIV to the Constitution of the United States, Section 1, provides: "* * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor

deny to any person within its jurisdiction the equal protection of the laws."

4. California Revenue and Taxation Code, Section 225 provides: "Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property."

Statement of the Case.

The Commerce Clause challenge at issue here results from an evolution of constitutional doctrine beginning with *Low v. Austin*, 80 U.S. (13 Wall.) 29 (1872). There the Court held that the Import-Export Clause prohibited states from imposing an ad valorem property tax on imported goods until they lost their status as imports and became commingled with the mass of property in the state. In ascertaining whether imported goods retained their character as imports, the Court endorsed a principle which came to be known as the "original package doctrine," first articulated in *Brown v. Maryland*, 25 U.S. (12 Wheat.) 262 (1827). Under this doctrine imported goods which remained the property of the importer in his warehouse in the original form or package in which they were imported were immune from state taxation. *May v. New Orleans*, 178 U.S. 496 (1900); *Hooven & Allison Co. v. Evatt*, 324 U.S. 652 (1945).

One hundred years after *Low v. Austin,* the decision of the California Supreme Court in *Volkswagen Pacific, Inc. v. City of Los Angeles,* 7 Cal.3d 48, 496 P.2d 1237 (1972), triggered a series of events which led to this case. *Volkswagen* held that receipts of a wholesaler from the sale of goods imported in a shipping container or sea van taken to the importer's warehouse where it was opened and the goods removed for sale and delivery to dealers lost their immunity from a city license tax.

The assessors of many California counties interpreted *Volkswagen* as holding that a shipping container or sea van containing imported goods constituted the original package for the purpose of the original package doctrine, and that upon opening such container or sea van, the imported goods lost their immunity from ad valorem property taxes. The assessments made by such assessors on goods that had been considered immune for over 100 years since this Court's decision in *Low v. Austin, supra,* caused consternation among importers. *See* Report of the Research Department of the Security Pacific National Bank (A. 28-49).

Prior to *Volkswagen,* California's neighbor, Oregon, and many other states had enacted statutes exempting from their property taxes goods brought into such states for shipment to other states, including goods imported from foreign countries.[2]

From the report of the Research Department of the Security Pacific National Bank it is also clear

[2]Citations to these statutes are set forth in Exhibit "A" hereto. A Commerce Clearing House list of states with "free port" laws and a brief analysis of the provisions thereof are reproduced in Appendix A of Petitioner's Reply to Response to Petition for Writ of Certiorari.

that firms which imported goods in shipping containers considered the California ad valorem tax to be a *major* problem; that such firms were either changing their operations or making plans to do so by diverting imports to "free port" areas and by relocating part of their facilities outside the state. Furthermore, such firms were not expanding their facilities in California (A. 41).

Thus, as a result of the assessments made by California assessors based upon their questionable interpretation of the *Volkswagen* case, California was faced with substantial deterioration of its import business occasioned by the diversion of imports to other states where partial exemption from property taxes was assured by virtue of such states' "free port" statutes.

The California legislature in 1975 enacted a free port statute, Revenue and Taxation Code Section 225, which provides for an exemption from property taxation of goods purchased outside the United States and brought into California for shipment and sale outside the state. Section 225 also provides an exemption for goods brought into California from other states for shipment outside the United States, but it does not provide an exemption for goods produced in the state or for goods brought into California from other states for shipment within the United States.[3]

[3]Effective January 1, 1980, business inventories will be exempt from property taxation in California. Cal. Assembly Bill 66, Ch. 1150, § 7 (1979), amending Cal. Rev. & Tax. Code § 219. However, the 36 free port laws of states other than California are in jeopardy, based upon Respondents' assertion that a statute which treats interstate and foreign goods more favorably than local goods is invalid on Commerce Clause grounds (Respondents' Response to Petition for Writ of Certiorari, p. 5). Thus the issues raised herein are of importance not only to California but to some 36 other states as well.

Shortly after Section 225 became effective, this Court in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), held that imports not in transit were no longer immune from state ad valorem property taxes. The Court overruled *Low v. Austin's* prohibition on state taxation of imports in their original packages. Although California was thus free to impose an ad valorem property tax on such imports, California's free port law which was enacted prior to *Michelin* remained in effect.

All of the facts of this case were stipulated to by the parties, and such stipulation was adopted by the trial court (A. 10-24).

On March 1, 1976, Petitioner was holding certain imported goods in warehouses located in Los Angeles County and the City of Compton. Petitioner brought these goods into California for distribution throughout the United States (A. 10), to be shipped as quickly as distribution operations permitted (A. 12). The rate of turnover averaged approximately three times per year (A. 12).

Pursuant to Section 225, Petitioner claimed an exemption for the imported goods in its warehouses on March 1, 1976. Respondents denied Petitioner's claim and imposed two assessments, one in the amount of $80,381.58 by the County of Los Angeles and the City of Compton, and another in the amount of $204,142.13 by the County of Los Angeles. Petitioner paid the assessments under protest and after exhausting its administrative remedies filed suit for refund (A. 12).

At trial, Respondents urged that the property tax exemption of Section 225 applied only to imported goods in transit and not to goods (such as those in

question here) held in warehouses while awaiting shipment to other states. Respondents also asserted that Section 225 violated the Commerce Clause of the United States Constitution. The trial court held for Petitioner on both issues and granted Petitioner the refund sought, entering judgment in the amount of the two assessments plus interest (A. 52-54).

The California Court of Appeal rejected Respondents' interpretation of Section 225, but held for Respondents on the ground that the section violated the Commerce Clause of the United States Constitution. In so ruling, the court reasoned that *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), prohibited any differentiation in state taxation between foreign commerce and interstate commerce (Pet. App. 10-18).

Summary of Argument.

1. California Revenue and Taxation Code Section 225 exempts from property tax goods imported into California for shipment and sale outside the state and goods brought into California from other states for exportation. However, goods produced in California and goods brought into California from other states for shipment within the United States are not exempt from tax.

The fact that Section 225 does not exempt goods brought into California from another state to be shipped to still another state does not render the statute invalid under the Commerce Clause.

California taxes intrastate goods precisely the same as interstate goods. Such tax treatment is unobjectionable. California taxes intrastate goods less favorably than certain out-of-state goods (imports and exports).

Unfavorable treatment of intrastate goods vis-a-vis out-of-state goods is permissible under the Commerce Clause, *Alaska v. Arctic Maid*, 366 U.S. 199 (1961), and under the Equal Protection Clause, *Allied Stores v. Bowers*, 358 U.S. 522 (1959).

Favorable tax treatment of foreign goods is not prohibited by any provision of the Constitution. Historically, Commerce Clause policy has been concerned with discrimination in favor of local business at the expense of interstate commerce. Section 225 is entirely consistent with such policy. It is also consistent with the policies underlying the Import-Export Clause as articulated in *Michelin Tire. Corp. v. Wages*, 423 U.S. 276 (1976).

Moreover, *Japan Line, Ltd. v. County of Los Angeles*, ... U.S. ...., 60 L.Ed.2d 336 (1979), not only permitted but required that in certain instances foreign commerce be treated more favorably than interstate commerce. Recent Congressional enactments in the tax field consistent with California's Section 225 also reveal a favorable treatment of imports and exports over interstate goods. Internal Revenue Code Sections 4271 and 4272.

The Court of Appeal misconstrued *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977), on which it relied heavily. There, New York devised a scheme which provided for a reduction in the rate of its stock transfer tax but only on the condition that the sale of the stock to be transferred also occur in New York rather than in another state, thereby benefiting stock exchanges in New York to the detriment of exchanges in other states. The Court, in striking down the New York scheme, applied classic Commerce Clause principles.

Section 225 imposes no coercive condition and is consistent with Commerce Clause principles. The California statute preserves tax neutrality between California and other free port states in a manner sanctioned by the court in *Boston Stock Exchange*.

2. The Court of Appeal held that the exemption accorded imported goods by Section 225 has the effect of offsetting tariff rates and does not give domestic manufacturers the protection from imports which Congress intended they should have. The court cited such effect as an additional reason for holding that the section violates the Commerce Clause.

In addition to California, some thirty-six states with free port laws provide for the exemption of imports shipped to other states. If the lower court's holding is correct then the laws of such states relating to the taxation of inventories of imports and domestic goods are also invalid.

Furthermore, some states completely exempt inventories or tax them at more favorable rates than those prevailing in other states. When imported goods shipped from such states compete with domestic goods subject to higher inventory tax rates, the imported goods enjoy an advantage similar to the advantage accorded imported goods by California and by the thirty-six states referred to above. There should be no difference so far as their validity is concerned between the property tax laws of a free port state and those of a state with either no inventory tax or a low rate of tax.

Such consequences are inevitable given (1) a nation composed of fifty states each having considerable autonomy, and (2) Constitutional policies ensuring the free

flow of trade among the states. These consequences can be eliminated only by requiring that all state tax laws applicable to inventories be uniform. Such a policy would destroy the principle of Federalism upon which the nation was founded.

3. No evidence was introduced to establish that Section 225 had an actual discriminatory effect upon interstate commerce. Such an effect was *assumed* by the Court of Appeal, and the statute was declared unconstitutional per se without any consideration of its effect. A per se test has been rejected by this Court in determining the validity of statutes under the Commerce Clause. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978).

The party attacking a statute as violative of the Commerce Clause has the burden of proving a substantial adverse effect on interstate commerce. To show that Section 225 had such an effect, several facts should have been established to demonstrate actual competition between comparable interstate and foreign goods competing in markets outside of California. Respondents made no attempt to establish any of the foregoing elements required to support their claim that the California statute is unconstitutional.

Even if a substantial adverse effect were shown to result, the California statute should not be declared unconstitutional unless it unduly burdens interstate commerce. Such a conclusion should not be reached without balancing the national interest in open trade against California's legitimate interest in exercising its taxing power.

ARGUMENT.

I

The Commerce Clause Permits California's Property Tax to Favor Foreign Commerce Over Interstate Commerce.

The instant case presents a question not heretofore decided by this Court: Does the Commerce Clause prohibit a state from according more favorable property tax treatment to imports and exports than it accords to goods produced in the state or to goods in interstate commerce?

A. The California Inventory Tax Structure.

All property in California on the tax lien date is subject to an ad valorem property tax unless such property qualifies for an exemption.[4] Section 225 exempts goods produced outside California which have a foreign origin or destination and which are held in California for shipment and sale outside the state. Goods held for sale in California are all equally subject to tax. Goods produced in other states and held temporarily in California are also subject to tax unless destined for exportation.

Thus, California's property tax system treats intrastate goods precisely the same as goods travelling in interstate commerce. It is axiomatic that such equal treatment is permissible.

B. The Constitution Permits a State to Place Local Business at a Disadvantage.

California treats intrastate goods less favorably than certain out-of-state goods, *i.e.*, imports and exports held

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[4]California Constitution Art. XIII, § 1; Cal. Rev. & Tax. Code §§ 201, 401.3.

for transshipment. As will be discussed, unfavorable treatment of local economic interests vis-a-vis outside interests is entirely consistent with the Constitution.

The Equal Protection Clause of the Fourteenth Amendment permits a state to tax local residents less favorably than nonresidents. In *Allied Stores v. Bowers*, 358 U.S. 522 (1959), the Court considered a challenge to an Ohio statute which, in an effort to promote local warehouse business, exempted from Ohio's property tax nonresidents' property stored in Ohio warehouses. The Ohio law did not accord a similar exemption to property of residents similarly stored. Emphasizing the wide discretion afforded the states in laying taxes and the attribute of sovereignty that entitles the states to devise fiscal systems appropriate to their needs, the Court rejected the challenge and approved Ohio's statutory discrimination in favor of out-of-state residents. *Allied Stores v. Bowers*, 358 U.S. at 526-27.

In *Alaska v. Arctic Maid*, 366 U.S. 199 (1961), the Court considered the validity under the Commerce Clause of an Alaska tax statute and reached the same result as in *Allied Stores*. Under the Alaska tax system, interstate taxpayers were taxed at a rate lower than local businesses with which they competed. The Alaska tax thus favored out-of-state interests over local businesses. The Court upheld the Alaska tax, reasoning that so long as the tax on out-of-state interests "did not exceed" the tax on local competitors, no unconstitutional discrimination existed.[5]

In short, as the Court stated in *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 291 (1978):

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[5]*See also Dunbar-Stanley Studios, Inc. v. Alabama*, 393 U.S. 537, 542 (1969).

> "The Commerce Clause does not concern itself with a State's decision to place local business at a disadvantage."

C. The Commerce Clause Is Directed at Prohibiting Discrimination in Favor of Local Business at the Expense of Interstate Commerce.

There is, however, an additional element of differentiation in the California tax system that presents the novel question in this case—the more favorable treatment accorded foreign goods in relation to goods travelling in interstate commerce. Respondents would have this Court extend the Commerce Clause to invalidate this distinction. Such an extension is not warranted. Despite the unusual claim of discrimination based upon California's statutory distinction between foreign and interstate commerce, traditional Commerce Clause analysis affirms the validity of Section 225. Prior decisions of this Court which addressed the question of discrimination against interstate commerce have held that the Commerce Clause operates to prohibit the states from discriminating in favor of local business at the expense of interstate commerce. Favoritism toward local interests is the *sine qua non* of a Commerce Clause violation:

> "[I]t must be regarded as settled that no State can, consistently with the Federal Constitution, impose upon the products of other States, brought therein for sale or use, or upon citizens because engaged in the sale therein, or the transportation thereto, of the products of other States, more onerous public burdens or taxes than it imposes upon the like products of its own territory." *Guy v. Baltimore*, 100 U.S. 434, 439 (1879). *See Halliburton Oil Well Cementing Co. v. Reily*, 373

U.S. 64 (1963). *Nippert v. Richmond*, 327 U.S. 416 (1946); *I.M. Darnell & Son v. Memphis*, 208 U.S. 113 (1908); *Welton v. Missouri*, 91 U.S. 275 (1875).

D. The Boston Stock Exchange Decision Is Distinguishable From the Instant Case, Was Misconstrued by the Lower Court, and Supports the Validity of the California Statute.

The Court of Appeal's decision in the present case flies in the face of the Commerce Clause principles historically applied in cases involving allegedly discriminatory taxes. In finding that Section 225 unduly discriminated between interstate and foreign commerce, the lower court relied heavily on *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977). But the court radically misconstrued the holding of that case. Rather than precluding Section 225's differentiation between interstate and foreign commerce, the principles underlying the decision in *Boston Stock Exchange* fully support the California exemption.

The New York statute challenged in *Boston Stock Exchange* taxed transfers of securities in New York by nonresidents at one rate if the sale of the securities occurred outside New York and applied a substantially lower rate if the sale occurred in New York.[6] The use of discriminatory tax rates depending on whether the sale occurred in other states or in New York was the method or tool employed to induce nonresidents to make their stock sales in New York rather than in other states. The purpose of such discriminatory rates was to benefit the stock exchanges in New York at the expense of exchanges in other states.

[6]In the case of large transactions a lower rate of tax was available to both residents and nonresidents if the sale occurred in New York.

In an effort to uphold the scheme, the New York Court of Appeals held that a sale by a nonresident outside the state followed by a transfer in New York constituted a transaction in interstate commerce and that a sale in New York by a nonresident followed by a transfer in New York was also a transaction in interstate commerce. The New York Court of Appeals held that the statute did not discriminate against interstate commerce in favor of local commerce but rather discriminated between two kinds of interstate transactions.

This Court in effect held that it was immaterial that the discrimination involved two types of interstate commerce. In striking down the New York scheme, this Court applied classic Commerce Clause principles, *i.e.*, that a state may not discriminate against interstate commerce in order to benefit local commerce.[7] Thus this Court held that discrimination between "two types of interstate transactions in order to favor local commercial interests over out-of-state businesses . . . is constitutionally impermissible." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. at 335.

The Court found that New York used "its power to tax an in-state operation as a means of 'requiring [other] business operations to be performed in the home state.'" 429 U.S. at 336. New York could not have directly required that sales of New York securities

[7]*Boston Stock Exchange* has recently been cited in support of the following proposition:

> "This Court consistently has struck down state and local taxes which unjustifiably benefit local business at the expense of out-of-state business." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 288 (1978) (Powell, J., dissenting). *See also* Maltz, *The Burger Court, The Commerce Clause, and the Problem of Differential Treatment*, 54 Ind. L.J. 165, 167 (1979).

to be transferred in New York must be made in New York rather than in some other state. This Court held that the state could not endeavor to achieve the same objective through the guise of a conditional reduction of its transfer tax—a method which was essentially coercive in nature. Such a scheme prevented a nonresident from making a tax neutral choice of exchange, creating an advantage for New York exchanges and a discriminatory burden on interstate commerce.

The present case presents completely different circumstances. The unconditional exemption of imported goods is not coercive. It was not designed to benefit local business at the expense of goods in interstate commerce nor does it have any such effect. These circumstances completely distinguish this case from *Boston Stock Exchange*.

The purpose of the exemption was to encourage import business to remain in the state by creating a condition of tax neutrality as between California and various other states with free port laws. Whether or not the exemption was extended to interstate goods was completely immaterial so far as achieving this objective is concerned.

The Court of Appeal read *Boston Stock Exchange* to stand for the proposition that differential tax burdens which favor one class of commerce over another are prohibited, irrespective of any purpose or effect to advantage the home state. (Pet. App. 15). The court thereby construed *Boston Stock Exchange* as prohibiting all state differentiations between types of out-of-state commerce. But the mere existence of tax differentiation between types of out-of-state commerce, with no benefit to local interests *resulting from* such differentiation,

does not violate the Commerce Clause.[8] As this Court has repeatedly and unequivocally held, the gravamen of a Commerce Clause violation is the benefit to local business that results from differential treatment. *Boston Stock Exchange* simply reiterates and applies this rule to the unusual facts of the case. Only by misinterpreting *Boston Stock Exchange* to preclude all differentiations between out-of-state transactions could the lower court conclude that Section 225 unduly discriminated against interstate commerce. The fact is that Section 225 is a perfectly legitimate exercise of state power under the rule of *Boston Stock Exchange* and is manifestly distinguishable from the New York statute held to be invalid in that case.

In this connection the following excerpt from *Boston Stock Exchange*—which is conspicuously absent in the Court of Appeal's opinion—is noteworthy:

> "Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce." 429 U.S. at 336-37.

What California did in enacting Section 225 is precisely the kind of "structuring" to which this principle is addressed. No preference is accorded local commercial interests. It is not the differentiation in tax treatment between foreign commerce and interstate commerce which may induce import business to remain in the state. It is the fact that imported goods in

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[8] *See Boston Stock Exchange, supra,* at 330 n. 11 suggesting that an exemption like California's would have been permissible.

California are exempt from tax. The tax differential itself—the only alleged vice of the California statute—can have no bearing on an out-of-state shipper's decision to use California's facilities. Thus, nothing in the *Boston Stock Exchange* decision supports the attack on Section 225's validity.

E. The California Statute Is Consistent With Constitutional Policies Articulated in the Michelin Decision.

Section 225 is not only consistent with underlying Constitutional policy, but even goes further than required to advance such policy. Perhaps the most comprehensive recent discussion by this Court of many of the constitutional policies relevant to the instant case was in *Michelin Tire Corp. v. Wages,* 423 U.S. 276 (1976). Although *Michelin* involved an analysis of the Import-Export Clause, it is established that the policies animating the Import-Export Clause and the Commerce Clause are much the same and that both Clauses were directed to similar concerns. *See Japan Line, Ltd. v. County of Los Angeles,* ..... U.S. ....., 60 L.Ed.2d 336, 348 n.14 (1979).

In *Michelin,* the Court dealt at length with the concerns which led the Framers of the Constitution to correct the major defects of the Articles of Confederation. The *Michelin* opinion highlighted three original concerns of the Framers: (1) The Federal Government must speak with one voice when regulating tariffs and commerce with foreign nations; (2) Import revenues should not be diverted to the states; and (3) Seaboard states should not be permitted to tax imports merely flowing through their ports to inland states to the detriment of citizens in states less favorably located. *Michelin Tire Corp. v. Wages,* 423 U.S. at 285-86.

An analysis of the concerns expressed in *Michelin* in the context of the instant case goes far to demonstrate that Section 225, by freeing imports from property tax burdens, advances each of the relevant constitutional interests. Taking these in order: (1) So long as a state forbears from imposing its property tax upon imports, as California has done in Section 225, Congress and the Federal Government are given maximum opportunity to speak with one voice to the extent necessary to regulate tariffs and foreign commerce; (2) Section 225 diverts no import revenues, directly or indirectly, to the states; and (3) Not only is California as a coastal state not taking advantage of its location at the expense of inland states, but rather it is facilitating the process of importation and exportation and thereby benefitting other states.

F. Federal Policy Encourages States to Favor Foreign Commerce Over Interstate Commerce.

The foregoing analysis demonstrates that the Constitution permits the states to give favorable treatment to imports and exports. In fact, state preferences for imports and exports have been constitutionally encouraged. Thus, in *Japan Line, Ltd. v. County of Los Angeles, supra,* the Court construed the Commerce Clause to favor foreign commerce over domestic commerce. There, the Court held that shipping containers used exclusively in foreign commerce are not subject to state property tax. However, domestic containers of the same type, when engaged in interstate commerce, are subject to state taxation. The County of Los Angeles argued in *Japan Line* that such discrimination in favor of foreign commerce and against interstate commerce is impermissible. The argument was deficient in *Japan Line* and is likewise deficient here.

In addition, recent federal legislation shows that California's exemption for imports and exports is entirely consistent with Congressional policy. The Airport and Airway Revenue Act of 1970, in order to compensate for the cost of Government services provided to air users, established a 5 percent tax on the amount paid for the transportation of property by air.[9] The Act, however, excludes from tax the transportation of imports and exports.[10]

The provisions of the federal tax on transportation of property by air are thus strikingly parallel to California's Section 225. The Federal provisions favor imports and exports by limiting the tax to domestic air transportation. Transportation of property in interstate commerce is taxed but foreign commerce is exempt. Moreover, Treasury Regulations issued under the Act provide flexible rules permitting stopovers, repackaging and consolidation of cargo in the course of movement without loss of exemption from tax.[11] California's Section 225 similarly provides that breaking in bulk, labeling, packaging, relabeling or repackaging of property is permitted without loss of exemption.

As pointed out at page 12 of the Brief for the United States supporting the Petition for Certiorari, "California's removal of property tax burdens upon imports and exports is therefore entirely consistent with congressional policy."

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[9]Pub. L. No. 91-258. H.R.Rep. No. 91-601, 91st Cong., 1st Sess., 38 (1969).

[10]Internal Revenue Code § 4272(a).

[11]26 C.F.R. § 154.2-1(c), (d).

II

The Exemption Accorded Imported Goods Did Not Frustrate Congressional Power in Establishing Tariffs.

The Court of Appeal held that the exemption accorded certain imported goods had the effect of regulating commerce by frustrating Congressional power in establishing tariffs. The reasoning of the court apparently was that the exemption accorded imported goods had the effect of offsetting tariffs, thus reducing the amount of protection Congress intended to give domestic manufacturers (Pet. App. 15-16). If the exemption is invalid on this ground, then the property tax laws of virtually all the other states would likewise be invalid.

Each of some thirty-six other states with free port laws exempts imported goods intended for shipment to other states. Most do not extend the exemption to goods produced in the state even though destined for out-of-state shipment. Thus imported goods passing through a free port state enjoy a competitive advantage in markets in other states over (1) goods manufactured in a free port state and shipped to other states, and (2) goods manufactured and taxed in other states.

There is also a similar problem with respect to the tax laws of states which do not have free port laws. Although they do not single out imports for preferential treatment, many of such states either exempt all inventories or tax inventories at rates lower than those prevailing in other states. If goods imported into any such state remained in the state of importation and competed

only with goods manufactured there, the tax laws of such state would not operate to "offset" tariffs. But this is not the case.

The competition of imported goods is not confined to goods manufactured in the state of importation. On the contrary, imports flow through the state of importation to other states. Once an import has been shipped into another state, it there competes with locally manufactured goods as well as goods manufactured in the other states. Thus, competition will exist between goods imported, goods manufactured in such state, and goods manufactured in other states. These goods will have been subject to different states' property taxes.

To suggest that the above differences in state property taxes result in interference with Congressional power to levy tariffs is far fetched. Differences in state tax laws are a corollary of Federalism. The nation is composed of fifty states each of which within broad limits is free to structure its tax laws as it sees fit. Except by coincidence they will not be precisely alike. The free flow of trade among the states and with foreign countries is also an attribute of Federalism. Therefore it is inevitable that consequences such as those discussed will occur.

Many differences among states' tax laws have long existed. It must be assumed that Congress was aware of such differences and adjusted tariffs accordingly or, more likely, ignored them.

In the overall context of the tariff making process, state property taxes are at most a minor item in the determination of manufacturing costs throughout the United States. Like California, most states impose a tax only on goods in the state on the state's tax

date—one day out of 365. As a result only a fraction of the total goods in the state during any given year are actually taxed.

During the year at issue in the instant case, 1976, the California tax rate on the market value of property varied between 3 and 3½%. A 50% exemption for inventories reduced the tax rate to 1½ to 1¾%.[12] In the case of the goods in question there was a turnover rate of three times per year, resulting in an average effective rate of tax of as little as ½%. (A. 12). Thus. even if there were some merit to the Court of Appeal's holding regarding frustration of Congressional power, the effect of the exemption in question was *de minimis*.

III

The California Statute Should Be Upheld Because No Impermissible Effect Upon Commerce Has Been Established.

A. The Lower Court Erroneously Applied a Per Se Test in Determining the Statute's Constitutionality.

No effort was made by Respondents to establish that the California statute had an actual discriminatory effect upon interstate commerce. The court below treated the statute as invalid on its face, thereby applying a *per se* test in determining the statute's constitutionality.[13] Thus, without any evidence on the subject. the court assumed that an unconstitutional effect existed.

[12]Cal. Rev. & Tax. Code § 219.

[13]The Court of Appeal assumed that since the statute accorded goods different tax treatment on the basis of their origin, "Foreign goods are thereby given a competitive advantage over interstate goods of the same nature and competing in the same market." (Pet. App. 11).

In this respect, the Court of Appeal was in error. This Court has rejected a *per se* test in determining the validity of statutes under the Commerce Clause. Earlier decisions suggested that state tax statutes might be invalidated on Commerce Clause grounds without considering their practical operation and effect. For example, in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602 (1951), the Court held invalid a state franchise tax on the ground that the tax was imposed upon the privilege of engaging in interstate commerce. The *Spector* approach deemed "irrelevant any consideration of the practical effect of the tax."[14]

In declaring the California statute unconstitutional, the Court of Appeal essentially followed the anachronistic *Spector* approach. The court held that the differentiation on the face of the statute between interstate and foreign commerce was *per se* unconstitutional and required no evidence whatsoever of the practical effect of the statute.

The *Spector* approach adopted by the Court of Appeal has been rejected by this Court. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). In *Complete Auto,* the Court upheld the validity of a tax similar to that stricken in *Spector* after considering its practical operation and effect:

> There is no economic consequence that follows necessarily from the use of the particular words [of the statute] and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect. . . . Accordingly, we now reject the rule of Spector Motor Service,

[14]*Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 278 (1977).

> Inc. v. O'Connor, that a state tax on the "privilege of doing business" is per se unconstitutional when it is applied to interstate commerce, and that case is overruled.[15]

In order to determine the validity of the California statute it is necessary to consider the effect the statute has upon interstate commerce. It would be an exercise in formalism to declare the statute unconstitutional based on speculative concerns of burdening interstate commerce. *Moorman Mfg. Co. v. Bair,* 437 U.S. 267, 280. The burden of proving that the statute has an unlawful effect rests upon Respondents, the parties attacking the statute.[16]

B. Respondents Failed to Establish That the Statute Has Any Effect on Interstate Commerce.

The potential effect of the California statute which the Court of Appeal assumed to be present is that the different tax treatment accorded foreign and domestic goods originating outside California and traveling through California to destinations outside the State could result in the foreign goods having "a competitive

[15]*Id.* at 288. More recently, the Court scrutinized the practical operation of a state tax statute attacked as discriminatory in *First Federal Savings and Loan Association v. State Tax Commission,* 437 U.S. 255, 259 (1978), and upheld the tax, holding that the federal savings and loan associations attacking the statute:

> [H]ave not, however, established that it is unfairly burdensome in "practical operation." The record does not indicate that federal associations have *suffered* a *significant handicap* in competing with state institutions, or that any other federal policies have been thwarted. (Emphasis added.) (Citation omitted.)

[16]*Metropolitan Casualty Ins. Co. v. Brownell,* 294 U.S. 580, 584 (1935); *Brown v. Maryland,* 25 U.S. (12 Wheat.) 262, 263 (1827).

advantage over interstate goods of the same nature and competing in the same market." (Pet App. 11). This, however, was a gratuitous assumption on the part of the lower court. There is no evidence in the record whatsoever to support it.

In order to show such an adverse effect on competition by interstate goods in the markets of other states, it would be necessary at a minimum to prove each of the following factors: (1) There must be a volume of traffic in goods brought into California from other states for shipment out of the state in interstate commerce; (2) Such interstate goods must be comparable to foreign goods similarly brought into California for shipment out of the state; (3) The interstate goods must be subjected to California property tax and the foreign goods must be exempted from such tax by reason of Section 225;[17] (4) The interstate and foreign goods must be shipped to markets in other states where they compete against each other.

No evidence was offered to prove any of the foregoing factors. The claimed discriminatory effect on competition is therefore hypothetical and speculative.

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[17]There are a number of reasons for believing that interstate as well as foreign goods may never become subject to California property tax. As the Court pointed out in *Michelin Tire Corp. v. Wages*, 423 U.S. at 288, state property taxes on goods can easily be avoided by the use of modern methods of transportation such as air freight, containerized packaging and railroads. In addition, it is common knowledge that merchants have for years avoided the property tax by letting their inventories become depleted shortly before a given tax date and then replenishing them shortly thereafter. *See* Keesling, *Michelin Tire Corporation v. Wages: The Demise of the Original Package Doctrine*, 50 So. Cal. L. Rev. 719, 725 (1977).

Even if these factors are assumed to exist, they would not establish the extent of the effect, if any, on commerce.[18] At most, the effect of the tax on competition in the markets of other states would be highly attenuated.

C. The Effect of the Statute, if Any, Is too Insubstantial to Place an Undue Burden on Interstate Commerce.

Assuming *arguendo* the existence of an effect on competition, the question remains whether such effect requires invalidation of the exemption under the Commerce Clause. At most, the policies of California may have resulted in a slight ripple effect on competition in markets outside of California. Respondents must show that the California exemption has a substantial effect which places an undue burden on interstate commerce.[19] The imposition of an ad valorem property tax such as that involved in *Michelin* has been characterized by the Court as having an insubstantial effect on the demand for the goods so taxed. *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 753 (1978).

Furthermore, even assuming a substantial adverse effect on commerce, in order to determine whether this constituted an undue burden it would be necessary

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[18]The extent of the effect was *de minimis*. See text accompanying footnote 12, *supra*.

[19]*Nippert v. Richmond*, 327 U.S. 416, 424 (1946). *See also Gregg Dyeing Co. v. Query*, 286 U.S. 472, 481 (1932):

> "Discrimination, like interstate commerce itself, is a practical conception. We must deal in this matter, as in others, with substantial distinctions and real injuries."

to make "the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers."[20] This determination requires an examination of "the unique characteristics of the statute at issue and the particular circumstances in each case."[21]

No such characteristics or circumstances were considered by the Court of Appeal. In light of the history, purpose and background of the statute,[22] its attenuated and problematic effect on commerce, and the lack of any precedent for an extension of the Commerce Clause to invalidate any such effect, Section 225 should be upheld.

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[20]*Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318, 329 (1977). "*Complete Auto* recognized that a state has a significant interest in exacting from interstate commerce its fair share of the cost of state government." *Department of Revenue v. Association of Washington Stevedoring Cos.,* 435 U.S. at 748.

[21]*Boston Stock Exchange v. State Tax Commission,* 429 U.S. at 329.

[22]The statute providing for the exemption in question was enacted in 1975 and became effective while the original package doctrine was still in effect. Notwithstanding the Constitutional immunity then accorded imports, it was well established that the state could tax other goods, including goods in their original packages, brought into the state from other states. Thus, there is little question but that the statute was valid at the time enacted. *Cf. First Federal Savings and Loan Association v. State Tax Commission,* 437 U.S. 255 (1978). The Legislature in enacting the statute involved was not displaying an unfriendly discriminatory attitude toward interstate commerce, but was simply following a pattern which had existed from time immemorial. Even after the decision of this Court in *Michelin* the different tax treatment of goods in interstate commerce was not due to any deliberate attempt or unfriendly attitude on the part of the California Legislature, but rather was due to the passive continuation of the *status quo ante* with respect to goods brought in from other states.

Conclusion.

For the reasons set forth herein, the opinion of the California Court of Appeal, Second Appellate District, should be reversed.

Respectfully submitted,

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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FOR ARGUMENT

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1978
No. 78-1577

SEARS, ROEBUCK & CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES and
CITY OF COMPTON,

Respondents.

RESPONDENTS' BRIEF

JOHN H. LARSON
County Counsel

JAMES DEXTER CLARK
Deputy County Counsel

648 Hall of Administration
Los Angeles, California 90012
(213) 974-1833

Attorneys for Respondents

Of Counsel

Kerry D. Safier
Arthur T. Forrester

Lawrence S. Rubinson
Diane Lebovits
Greason Haworth

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JAMES DEXTER CLARK
Deputy County Counsel

648 Hall of Administration
Los Angeles, California 90012
(213) 974-1833

Attorneys for Respondents

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Respondents.

RESPONDENTS' BRIEF

PRELIMINARY FACTS

The following things should be brought to the attention of this Court at the outset:

1. REVENUE AND TAXATION CODE §225 IS NOT A TAX. IT IS A SERIES OF EXEMPTIONS WITH THE SPECIFIC PURPOSE OF REGULATING COMMERCE.

2. ALTHOUGH §225 (AND THE TAXES IMPOSED BY RESPONDENTS) OPERATE

ON GOODS HELD IN CALIFORNIA FOR SEVERAL MONTHS (OR MORE), THE STATUTE GIVES EXEMPTIONS ONLY UPON THE HAPPENING OF EVENTS OUTSIDE THE STATE AND OUTSIDE THE COUNTRY. (EXTRATERRITORIAL CONDITIONS.)

3. CERTAIN TYPES OF INTERSTATE AND FOREIGN COMMERCE MUST BE ENGAGED IN FOR THE STATUTE TO BE OPERATIVE.

THE FACTS AND THE STATUTE

The Petitioners act as dealers of goods at either retail or wholesale. They sell goods to customers located throughout the United States. Sears holds a large quantity of imported goods and a small quantity of American goods in the County of Los Angeles for distribution throughout the United States. Sears holds its goods for a period of months.

After holding the goods as described, some of the goods are sent to out-of-state customers and outlets while others are sent to California customers and outlets. The foreign goods sold or distributed to California customers are taxable under §225 while the foreign goods sold or distributed to non-California customers are not taxable pursuant to that statute.

The American goods held by Sears in the taxing jurisdiction are taxable under §225. On the basis of the evidence before it, the state court found that American goods originating in other states arrive in California for distribution or sale to other states and are taxable. 1/

SUMMARY OF ARGUMENT/INTRODUCTION

R. & T. §225 was enacted before Michelin Tire Corp. v. Wages, 423 U.S. 276, 46 L. Ed. 2d 495, 96 S. Ct. 535, was rendered by this Court. The legislative record (Case Record p. 219, last paragraph) shows no intent by the Legislature to alter the competitive status quo between domestic and foreign goods. In fact, the authority of the Federal Government to make such changes was conceded by the State Legislature to be Supreme. (Record p. 219, last sentence.)

When Michelin was handed down, the State Court of Appeal was presented with two choices. It could have "redesigned" R. & T. §225 to prevent the discriminatory effect, or it could have told the Legislature to "go back to the drawing boards." It took the latter approach. The Legislature has now created a total inventory exemption, Assembly

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1/ The Petitioners have argued that the State Court's findings on this point may not be considered by this Court (but see American Oil Co. v. Neill, 380 U.S. 451, 455-6 (1965) and Gurley v. Rhoden, 421 U.S. 200, 208 (1975) and discussion, infra).

Bill No. 66, Chapter 1150, 219(a)(4), which has the same effect on imports, but no longer discriminates between forms of commerce. In addition, the Legislature is considering paying back the taxes collected, including those at issue in this case (Senate Bill 940 of 1979).

The Petitioner, however, seeks to have this Court sustain the discrimination of the statute under misapplied constitutional law. Moreover, the Petitioner has argued that statutes which were not unconstitutional when enacted may still continue in effect, even after decisions of this Court render them unconstitutional.

The Petitioner contends that provisions of the United States Constitution do not prohibit what has become a narrow, special-interest exemption. Petitioner argues that states may, as a general rule, enact such narrow interest exemptions on various grounds.

First, Petitioner asserts that this Court must restrict the ambit of "free trade" under the commerce clause to statutes purposely discriminating against out-of-state commerce. (See p. 16, par. 2 of Petitioner's Brief.) The Petitioner (and strangely enough the Solicitor General) argue that a statute's purposes can be separated from its discrimination. Thus (concludes the Petitioner), if a statute creates discrimination then this Court must disregard it if the Legislature did not have that discrimination in mind.

The difficulty with this two-step analysis is that the commerce clause deals with

regulations, not what a legislator had in mind. The commerce clause creates an area where discriminatory effects by the states are prohibited. Neither logic nor the commerce clause allows a discriminatory regulation to exist even though the Legislature did not envision all of the discrimination created.

Next, the Petitioner and the Solicitor General argue that the commerce clause allows discriminatory regulations as long as they favor foreign interests. (Solicitor's Brief p. 8, Petitioner's p. 19.) In effect, they tell this Court that the federal control of foreign commerce is only "half exclusive." The argument is based on the unsupported assumption that the Federal Government regulates foreign commerce solely for the benefit of foreigners. The Petitioner and the Solicitor General incorrectly propose that the states may give more benefits to foreigners because they will not be hurting anyone Congress may wish to protect.

Next, the Petitioner relies on the idea that the states may place local businesses at a disadvantage. This reliance is misplaced. Unique among similar statutes, R. & T. §225 establishes a discriminatory regulation in such a way as to burden both out-of-state manufacturers and out-of-state customers at the same time. R. & T. §225 relies only upon the temporary storage of the goods in the state to apply the regulation.

Next, the Petitioner and the Solicitor General argue that compliance with the import-export clause constitutes compliance with the commerce clause. (Solicitor's Brief p. 8, Petitioner's Brief

Brief p. 20.) This argument is illogical on its face.

In any case, the foundation for the argument immediately above is not available to Petitioner. R. & T. §225 prevents the Federal Government from speaking with one voice (Michelin Tire Corp. v. Wages, supra). It changes the competitive status between foreign and domestic goods, stored in the state under exactly the same circumstances. The fact that (1) the President has sought to apply additional tariffs in order to protect domestic industry, and (2) the Solicitor General attempts to support the regulation by asserting that protective tariffs are consistent with state legislation that reduces their effect, is direct evidence that the Executive Branch of the U.S. Government cannot speak with one voice and still support R. & T. §225.

The Petitioner further argues that if this Court affirms the Court of Appeal, then many other state statutes must necessarily be invalidated. The implication of this argument is that the existence of other state statutes makes R. & T. §225 constitutional. The argument is further based on the assumption that all of the state statutes cited would be interpreted in the same way as R. & T. §225.

But R. & T. §225 is unique. It is the only statute which utilizes the mere storage in the state to impose a regulation which discriminates between both out-of-state manufacturers and out-of-state customers. 2/ Furthermore, there is no constitutional

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2/ The Florida statute (Taxation & Finance Code §196.0011) does have closely parallel language, but (continued on p. 7)

support for the proposition that one state statute can make another state statute constitutional.

The only conceivable purpose the Petitioner may have in presenting these statutes to the Court is to persuade it that it will confuse commercial affairs if it rules for the Respondents. But the opposite is the truth. The Petitioner and the Solicitor General actually propose rules which will increase confusion by allowing 50 separate systems of foreign-interstate regulation to be imposed on goods passing through the states. Even those regulations which may appear to help some foreign interests will, at the same time, hurt others. For instance, any foreign company buying

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2/ (continued from previous page)

equates "transshipment" with "in transit." The California Court's broad reading of R. & T. §225 is based upon those terms being used differently. Also §196.0011 requires contracts of sale to out-of-state customers to be in hand by the lien date. California's R. & T. §225 allows any foreign goods eventually shipped out of the state to escape taxation (see R. & T. §251).

The statutes from Georgia and Louisiana are the only other state statues making the foreign-interstate distinction (see Ga. Code Annotated §92-186-87 and La. Rev. Stat. Ann. 47-1951.3). But only goods "in transit" are exempted by those statutes. All of the other statutes do not punish one set of out-of-state customers in comparison with another.

manufacturing facilities in the U.S. will be hurt in comparison with its foreign competitors manufacturing abroad. "Helping" foreign goods is not necessarily helping foreigners.

The proposition that Congress regulates foreign commerce only to help "foreign goods" also serves as the foundation for the Petitioner's arguments concerning the many long-standing protective tariff acts (including the Tariff Act of 1930, 46 Stat. 590, and the Trade Act of 1974, 88 Stat. 1978). These "Tariff Acts" are designed to a great extent to protect domestic industry. The Solicitor General specifically does not deal with this issue.

The Petitioner, however, asserts that benefits accorded to foreign goods and not to domestic goods merely "supplement" the tariffs. (Petitioner's Brief pp. 21-22.) The argument is so illogical that it could be reversed. One could argue that since tariffs are protective in nature, further protection given by the states for domestic goods is a "supplement" to that protection.

Of course, both ideas are incorrect. The Congress of the United States is empowered to determine "what articles may be imported into this country and the terms upon which importation is permitted." Board Of Trustees Of the University Of Illinois v. U.S., 289 U.S. 48, 57. State action reducing tariffs is no more authorized than state action adding to them.

In addition, both the Tariff Acts and the U.S. Constitution require uniform tariffs.

(Art. I, Cl. 8, §1; 19 U.S.C.S. 1502(a).) The Petitioner would have this Court rule that a state may alter that uniformity.

Varying levels of state taxation are indeed a function of our federal system. But specific state regulations favoring foreign goods, while not favoring domestic goods held in the state under exactly the same circumstances, is not fair, not uniform, and not constitutional. Such regulations undermine understandings created between Congress and the Executive Branch on the one hand and foreign producers, foreign investors in this country, and this country's own businesses on the other.

This Court should not create a rule which would allow the States to regulate in this fashion. If R. & T. §225 is upheld as not reducing Federal tariffs, then every state through which imports and American goods pass, may effectively alter the foreign-interstate equilibrium for goods held at the same place, at the same time, and for the same purposes.

The Petitioner cannot avoid this effect by simply saying that different states have different taxes. (See Petitioner's Brief p. 22.) Those other states do not subject foreign goods and interstate goods to different regulation. As a result, the foreign producer and the out-of-state American producer have exactly the same burdens to face when sending their goods through any other state. California cannot take advantage of its position as a port state to oblige one manufacturer to pay burdens as the goods go through the state, while letting another manufacturer's

goods move through the state without payment.

The Petitioner attempts to avoid the effect of the Tariff Acts by asserting that the amount of difference is not substantial. (See Pet. Brief p. 27.) It relies on an average "turnover" rate of inventory. Of course, goods can be held in the state for even a full year (or more) and still enjoy the benefit of the regulation. Thus, a full 1 3/4% effect is possible. In addition, the amounts of differential resulting from R. & T. §225 are, in some cases, actually more than the amount of certain tariff rates.

In conclusion, the Petitioner seeks to have this Court uphold a regulatory power in the States to differentiate between foreign and interstate goods passing through a state. They seek to have this Court uphold such regulatory power, even though the California Legislature has effectively repealed R. & T. §225.

ARGUMENT

I
THE STATUTE

A. The Petitioners' Goods Are Not In Transit:

It is accepted by all of the parties that any goods which are in transit through a state are immune under the commerce clause (see

Minnesota v. Blasius, 290 U.S. 1, 78 L.Ed. 615, 33 S.Ct. 299 (1913)).

The Petitioners do not claim that their goods are immune because they are in transit. They claim rather, an exemption created by California's Revenue and Taxation Code §225 (reproduced here as Appendix "A" and hereinafter cited as R. & T. §225).

The California Court of Appeal interpreted R. & T. §225 to exempt goods held in California until sold or distributed (see Zee Toys, Inc. v. Sears, Roebuck & Co. v. County of Los Angeles, 85 Cal.App.3d 763, at pp. 770 to 772, 149 Cal. Rptr. 750 (1978)).

Thus, the goods involved in this case were not moving, or otherwise in transit. But R. & T. §225 does impose its regulatory conditions merely on the basis of their temporary presence.

B. R. & T. §225 Creates an Unequal Tax Treatment Between Forms Of Interstate Commerce Solely On the Basis Of Their Place Of Destination and Their Point Of Origin.

Goods flowing from other states into California for warehousing and then on to Mexico, are exempt under R. & T. §225 (unless those goods are assembled or painted, i.e., some form of manufacturing process, in California). But

similar goods flowing from other states into California and stored in the same warehouse prior to transshipment on to other states are taxed. Thus R. & T. §225 directly discriminates against some forms of interstate commerce in favor of other forms of interstate commerce (those which flow out of the United States into foreign commerce).

R. & T. §225 discriminates between competitors in interstate commerce who warehouse their goods in California for transshipment, depending upon both the destination and the point of origin of the goods. For instance, R. & T. §225 requires that the conditions of foreign manufacture and out-of-state sale or distribution be satisfied before the exemption applies.

Furthermore, goods assembled in California and shipped outside the United States are taxable, but goods assembled in another state and shipped through California are exempt. So, R. & T. §225 favors goods assembled in other states destined for foreign commerce, while it discriminates against goods assembled in California destined for that same foreign commerce. This is true, even if the goods assembled in California came from other states before being assembled.

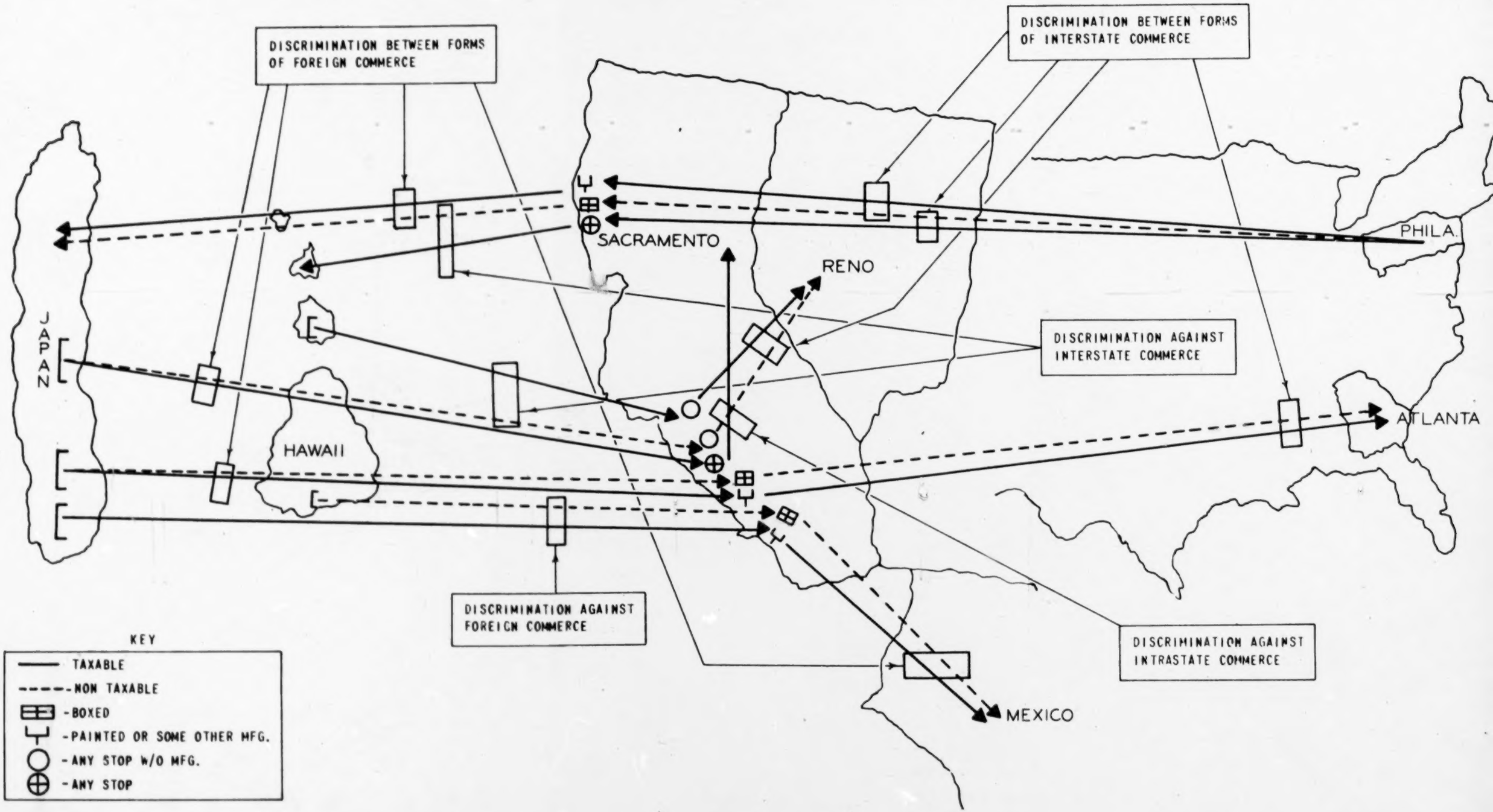
R. & T. §225 distinguishes between types of foreign commerce and distinguishes between types of interstate commerce.

C. R. & T. §225 Redirects the Free Flow Of Commerce

California is precluded from taking any action impeding the free flow of trade between States. See Freeman v. Hewit, 329 U.S. 249. R. & T. §225 impedes the free flow of commerce by its complex extraterritorial conditions. These conditions encourage some producers to store goods in California, while discouraging others. Those conditions also encourage out-of-state exporters to paint their goods in other states but to package them in California (see the definition of "manufacturing" used in §225, App. A). Thus, the free flow of commerce is selectively redirected. 3/

Because R. & T. §225's conditions are extraterritorial and many-faceted, a map has been produced to demonstrate what the conditions do (see p. 13a).

3/ When one considers that many other states exempt all goods coming into the state (whether foreign or domestic), the effect is compounded (see Collection of Statutes described in Amicus Curiae Brief on behalf of Pioneer Electronics, etc., in support of Petition for Certiorari, Exhibit D).


DISCRIMINATION BETWEEN FORMS OF FOREIGN COMMERCE
DISCRIMINATION BETWEEN FORMS OF INTERSTATE COMMERCE
SACRAMENTO
PHILA.
RENO
JAPAN
DISCRIMINATION AGAINST INTERSTATE COMMERCE
HAWAII
ATLANTA
DISCRIMINATION AGAINST FOREIGN COMMERCE
DISCRIMINATION AGAINST INTRASTATE COMMERCE
MEXICO
KEY
TAXABLE
NON TAXABLE
-BOXED
-PAINTED OR SOME OTHER MFG.
-ANY STOP W/O MFG.
-ANY STOP

II
THE COMMERCE CLAUSE

A. The Arguments Of the Solicitor General and the Petitioner

1. The Petitioner's Arguments

a. The Petitioner (and the Solicitor General) Contend That the Exclusive Authority Of Congress to Regulate Foreign Affairs and Commerce Is Only "Half-Exclusive." (Pet. Brief pp. 11, 19-20.)

Surprisingly, the Solicitor General and the Petitioner have both argued that the States may

regulate foreign commerce, but only if they discriminate in favor of foreign goods. The assumption underlying this argument is that Congress has (or will) regulate only in favor of foreign interests. Building on this foundation, the Petitioner and the Solicitor General point to various statutes which favor air carriers coming into or going out of the country. The Solicitor General and the Petitioner claim that tax exemptions for all flights going into or out of the country parallels R. & T. §225 (which favors only some imports and exports, but not all).

The Petitioner and Solicitor General thus conclude that the States may favor foreign goods over interstate goods passing through their jurisdictions.

Both of them fail to deal with the fact that Congress, when considering levies directly on the goods themselves, has sought to benefit interstate and domestic goods over foreign goods (see the Tariff Acts, esp. 19 U.S.C. 1202, 1338, 2153).

Both of them fail to deal with the fact that Congress often makes concessions for foreign interests in order to achieve reciprocal benefits for American interests abroad (19 U.S.C. §2112(a)).

Finally, both of them fail to deal with the fact that R. & T. §225 will actually hurt foreign interests which operate manufacturing plants in America. [4/] R. & T. §225 would have this effect

[4/] See Appendix "B" excerpts from "Conditions of Competition in the Western U.S. Steel Market

(continued on p. 16)

by subjecting the local operation of a Japanese company to property taxes on its goods flowing through the state, while not imposing similar burdens on a Japanese company not doing any manufacturing in this country.

Thus, the Petitioner and Solicitor General, in effect, require this Court to utilize selective logic when reviewing R. & T. §225.

b. The Petitioner Contends That This Court Must Ignore the Conditions Imposed By R. & T. §225 If Those Conditions Operate Against In-State Businesses (Pet. Brief pp. 11-13). 5/

The Petitioner seeks to further restrict the vision of this Court. It implies that discrimination

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4/ (continued from previous page)

between certain domestic and foreign Steel Products" United States Int'l Trade Comm. Pub. 1004, September 1979.

5/ Petitioner relies on Alaska v. Arctic Maid, 366 U.S. 199 (1961) and Allied Stores v. Bowers, 358 U.S. 522 (1959) (concurring opinion). The Petitioner's logic seems to be based on the assumption that in-state businesses have more influence with state legislatures than out-of-state businesses. In light of the complexity of today's interstate and foreign commerce, this is difficult logic to support.

against "local" business cures a statute which also discriminates between forms of interstate and foreign commerce. The Petitioner cites no authority for this proposition.

c. The Petitioner and the Solicitor General Argue That the Only Discrimination Prohibited By the Commerce Clause Is That Which, On Its Face, Favors Local Business At the Expense Of Interstate Commerce (Pet. Brief pp. 13-18).

In an effort to avoid the impact of this Court's opinion in Boston Stock Exchange v. State Tax Comm., 429 U.S. 318 (1976), the Petitioner asks this Court to ignore certain features of the statute.

The Petitioner preliminarily asserts that the exemption had the purpose of reversing the flow of commercial traffic away from the California (see Pet. Brief p. 5, par. 2). 6/ But in its commerce clause argument the Petitioner states,

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6/ The Assessor's interpreation of the law is not "questionable" as the Petitioner asserts there (see Craig Corp. v. County of Los Angeles, 51 Cal. App. 3d 909, 124 Cal. Rptr. 621 (1975) and Keesling, Michelin Tire Corporation v. Wages: The Demise of the Original Package Doctrine, 50 U.S.C. Law Review 719 at pp. 740-742 (1977).

"No preference is accorded local commercial interests."
(Pet. Brief p. 17.)

It may be that Petitioner is saying that the exemption must be seen only with logical blinders on. The Petitioner may be suggesting that this Court ignore the fact that R. & T. §225 requires a host of foreign and interstate prerequisites to be satisfied before the exemption is allowed.

If so, the Petitioner is asking this Court to separate an exemption from its conditions. R. & T. §225 requires a series of conditions. These conditions are: foreign manufacture, foreign commerce, no manufacturing while in the state, followed by interstate commerce. It operates to give the exemption only when all of these pre-requisites are satisfied. The Petitioner simply asks this Court to ignore those conditions.

Once this feat is accomplished, the Petitioner urges this Court to apply the statutory purpose, not to the conditions for receiving the exemption, but to the exemption "itself."

Based upon this foundation, the Petitioner asserts that this Court must ignore Boston Stock Exchange v. State Tax Comm., supra, because in that case the conditions for the exemption had the purpose of diverting business into the state. In contrast, says the Petitioner, the conditions for receiving the exemption do not serve the purpose of diverting traffic into the state.

By its argument, the Petitioner makes clear what has been suspected: there is no local purpose to the conditions for the exemption.

R. & T. §225 would achieve exactly the same result if there were no involved and conflicting conditions. 7/

The Petitioner, in its attempt to distinguish Boston Stock Exchange v. State Tax Comm., supra, has offered no state purpose for the conditions embodied in R. & T. §225. 8/

7/ In fact, the California Legislature has already applied the exemption to all inventory without requiring any conditions. The regulatory character of R. & T. §225 has thus been eliminated. The Legislature is also considering refunding the taxes collected (see Assembly Bill 66 and Sen. Bill 940, supra).

8/ In fact, the Petitioner makes clear that R. & T. §225's conditions are unconstitutional under the equal protection clause. In Allied Stores v. Bowers, 358 U.S. 522 (1959), this Court ruled that an exemption can be sustained on equal protection grounds if there is a rational basis for the classification created by it. The Petitioner has pointed to no rational purpose underlying the classification created by R. & T. §225.

d. The Petitioner and the Solicitor General Contend That the Nation Can Speak With One Voice Despite State-Initiated Tariff Reductions. They Further Contend That Compliance With the Import-Export Clause Is the Same Thing As Compliance With the Commerce Clause (Pet. Brief pp. 18-19).

First, the Petitioner repeats its contention that in this case the constitution permits the States to regulate between forms of commerce. Next, the Petitioner announces that R. & T. §225 "furthers" commerce clause policies by its regulatory conditions. Finally, the Petitioner argues that R. & T. §225 comports with the import-export clause purposes as announced by this Court in Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976).

The Petitioner and the Solicitor General assert that the Court must again put on its blinders when determining whether a regulation permits the Federal Government to "speak with one voice." The Petitioner and Solicitor General actually suggest that this Court cannot consider the effect of the statute on goods not exempted.

Thus, the Petitioner and Solicitor General ask this Court not to consider the goods (both foreign and interstate) which do not satisfy the conditions

imposed by R. & T. §225. 9/

The Petitioner and Solicitor General imply that even though some foreign interests are harmed by R. & T. §225, and even though interstate interests are hurt, the statute is saved simply because it exempts some foreign goods. Both the Petitioner and Solicitor General ignore the fact that tariffs and other regulations of foreign commerce depend, for their effect, on the existence of a class of goods not subject to duty, i.e., domestic goods.

The Petitioner has failed to deal with the fact that the Tariff Acts require uniformity and are in large measure meant to protect the very interstate commerce that the Petitioner would ignore.

9/ Perhaps one of the most unusual aspects about this argument is that the Solicitor General argued in a previous case, only one year ago, that the effects on property not involved in that case, and the consequent effect on the competitive situation, should be reviewed by this Court in order to determine the validity of a uniform tax (see Brief of Solicitor General in Japan Lines Ltd. v. County of Los Angeles, No. 77-1378, p. 29). The Solicitor General appears to be arguing that when favoring any foreign interest (or part thereof), the States are subject to less review by this Court.

e. The Petitioner and Solicitor General Argue That the Existence Of Federal Exemptions For All "Foreign Flights" Validates a State Exemption For Some Foreign Goods. They Further Argue That the Existence Of These Statutes Shows a Consistent Federal Policy Favoring Foreign Goods (Pet. Br. pp. 19-20).

Now the Petitioner asks this Court to take off the blinders. The Petitioner asserts that this Court's treatment of foreign commerce in Japan Line Ltd v. County, supra, compared with interstate commerce, shows that the States may go further in regulating against interstate commerce. Both the Petitioner and the Solicitor General argue that an interpretation of the United States Constitution requiring the States to refrain from certain action actually constitutes constitutional authorization for more action in the same "direction." 10/

10/ We have already seen that favoring some foreign goods is not necessarily favoring all foreign interests. The "direction" called for by any particular constitutional requirement would not be a very clear one under the rule proposed by the Petitioner and Solicitor General.

The Petitioner and the Solicitor General continue to focus on the comparison between interstate and foreign goods when it suits their arguments. They refer to federal exemptions in airline gas and "service" taxes. Although they close their eyes to the interstate-foreign comparison in connection with tariffs, the Petitioner and Solicitor General open them when reviewing these exemptions. Neither of them point to the amount of imports or exports shipped by air.

But the open eyes of the Petitioner and Solicitor General are only half open. They ignore the fact that R. & T. §225 does not apply to goods eventually sold to California customers. The federal exemptions apply whether the flight ends in California or not.

Thus, the conclusion of the Solicitor General that federal statutes are consistent with R. & T. §225 is based upon the ability to see comparisons at some times, but not at others. This "selective logic" is the only thing that is consistent with R. & T. §225.

f. The Petitioner Argues That This Court Cannot Accept a State Court's Characterization Of the Ambit Of a Regulation. (Pet. Brief pp. 23-29.)

The Petitioner asserts before this Court, for the first time, that there are no "facts." It characterizes the Court of Appeal's determination of the ambit of the statute as an assumption.

The Petitioner simply ignores the facts before the Court of Appeal. Those facts included evidence to the effect that there is a substantial stream of interstate commerce going through California (see Zee Toys, Inc. v. County, 85 Cal. App. 3d at p. 768, 149 Cal. Rptr. at p. 754). In its brief before that Court, the Petitioner simply assumed that the amount of interstate traffic was small (see Court of Appeal Respondent's (Sears') Brief, p. 48) (but see App. B).

Now, since Zee Toys is no longer a part of the action, the Petitioner asserts that there are no facts to determine the impact of R. & T. §225 on interstate commerce. The Petitioner concludes that the statute must, therefore, be constitutional.

Next, the Petitioner ignores the effect which is most clearly demonstrated by its own fact situation. (See Stipulation of Facts herein.) R. & T. §225 clearly distinguishes between (1) foreign commerce eventually resulting in an out-of-state sale or distribution and (2) other foreign commerce.

g. The Petitioner Argues That Since It Is Likely That Foreign and Interstate Goods Will Escape Taxation In California, This Court Should Assume That No Interstate Goods Are Taxed. (Pet. Brief p. 26 fn. 17.)

The Petitioner contends that "interstate as well as foreign goods may never become subject to California property tax." The implication is that if they are not taxed, there is no discriminatory effect.

The Petitioner, at the outset, ignores the inhibiting effect of a regulation on a foreign or interstate manufacturer in sending his goods through California. (See Boston Stock Exchange v. State Tax Comm., supra, at p. 334 fn. 13.)

The Petitioner also ignores the fact that if property taxes can be avoided, there would be no reason to enact an exemption. It also ignores the added cost of avoiding a tax. Under R. & T. §225, foreign goods will not have to pay that cost. American goods will pay that cost.

h. The Petitioner Asserts That Some Of Its Goods Were Taxed At a Rate Of 1/2% Ad Valorem and That Such a Rate Is De Minimus. (Pet. Brief pp. 22-23.)

The Petitioner refers to an average amount of time its goods are in the jurisdiction, concludes that the "effective" rate on all of its goods is 1/2% of their value, and asserts that this is too small to notice.

The Petitioner ignores the fact that it has placed this matter before this Court and is contending that all of the States are allowed to enact similar regulations against interstate goods passing through their jurisdictions.

The Petitioner further ignores the fact that the Tariff Acts regulate the foreign-domestic difference in amounts as low as 0-3% ad valorem. (See App. C, herein.) The Petitioner does not state why a State regulation amounting to up to 1 3/4% is not important when the U.S. Congress has seen fit to impose tariffs in less than that amount. (The tax on goods held for one year is effectively 1 3/4%. See Pet. Brief p. 23.)

The Petitioner also ignores the fact that the amount of difference created by R. & T. §225 is far more than that created by the regulation in Boston Stock Exchange v. State Tax Comm., supra (429 U.S. at p. 334).

i. The Petitioner Argues That a Regulation If Valid Under a Prior State Of the Law, Will Continue to Be Valid Under a New State Of the Law. Petitioner Further Argues That a Regulation's Discriminatory Effects May Be Ignored If Not Caused By an "Unfriendly Attitude" By the Legislators Enacting It. (Pet. Brief p. 28 fn. 22.)

The Petitioner asserts that because part of the statute was consistent with the original package doctrine before Michelin Tire Corp. v. Wages, supra, all of it should be valid now. 11a/ The Petitioner relies on First Federal Savings & Loan Assoc. v. State Tax Comm., 437 U.S. 255 (1978) for this proposition. (Pet. Brief p. 28 fn. 22.)

In making this argument (i.e. that R. & T. §225 had no effect before Michelin Tire Corp. v. Wages, supra), the Petitioner ignores its arguments below; that no statute would ever be enacted which conformed to an already existing constitutional immunity (see Sears Brief before the Court of Appeal, pp. 24-27).

The Petitioner next contends that the California Legislature did not display an unfriendly attitude toward interstate commerce. Of course, a lack of "unfriendly attitude" will not validate a statute. But, in any case, the Petitioner ignores

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11a/ The Solicitor General points out that R. & T. §225 is not the same as the original package doctrine as interpreted before 1976 (Solicitor General's Brief p. 10 fn. 5).

the "unfriendly attitude" toward interstate and foreign commerce resulting in exportation. Without any constitutional support, R. & T. §225 discriminates between both types of commerce. It discriminates between them on the basis of any amount of "manufacturing" (as opposed to packaging and labelling, for instance). As the Solicitor General points out, R. & T. §225 also gives more advantage to foreign goods than the original package doctrine ever did (see Solicitor General's Brief p. 10 fn. 5).

B. The Selective Exemption Is Prohibited By the Commerce Clause, and Involves the Same Situation As Was Before This Court In Boston Stock Exchange v. State Tax Comm., Supra.

1. This Court Has Specifically Endorsed a "Per Se" Approach In Dealing With Selective State Economic Regulations Of Commerce.

The Petitioner emphasizes its theory that no statute can be unconstitutional without "additional" evidence.

Of course, this Court has reviewed many statutes on the basis of the language present. It has addressed the precise issue raised by Petitioner. In Philadelphia v. New Jersey,

437 U.S. 617 (1978) the Court said,

> "The opinions of the Court through the years have reflected an alertness to the evils of 'economic isolation' and protectionism, while at the same time recognizing that incidental burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people. Thus, where simple economic protectionism is effected by state legislation, a virtually per se rule of invalidity has been erected." (437 U.S. at pp. 623-624.) (Also see H. P. Hood & Sons v. DuMond, 336 U.S. 525, 535.)

But what about partial economic protection? What if only part of out-of-state commerce is affected?

This Court previously answered that question in Boston Stock Exchange v. State Tax Comm., supra. This Court faced the problem of a statute which caused one part of interstate commerce to be taxed while another part was not. The Court stated,

> "A State may no more use discriminatory taxes to assure that nonresidents direct their commerce to business within the State than to assure that residents trade only in intrastate commerce. As we stated at the outset, the fundamental purpose of the Clause is to assure that there be free trade among the several

States. This free trade purpose is not confined to the freedom of trade with only one State; it is a freedom to trade with any State, to engage in commerce across all State boundaries." (429 U.S. at p. 355) (emphasis added).

The Court later affirmed that state statutes which divert commerce from other states by this means are ". . . virtually per se illegal." (429 U.S. at p. 336.)

2. Neither Boston Stock Exchange v. State Tax Comm. Nor Philadelphia v. New Jersey Can Be Avoided On the Ground That Foreign Commerce Is Involved. In Fact, the Regulation Of Foreign Commerce Is an Exclusive Federal Power.

The Petitioner and Solicitor General seek to avoid the rule in Boston Stock Exchange by pointing out that foreign commerce is involved here, and was not involved in Boston Stock Exchange.

But both the Solicitor General and this Court have repeatedly announced that the area of foreign commerce is more exclusively under Federal control than interstate commerce. (See e.g., Buttfield v. Stanahan, 192 U.S. 470, 492-493 (1904); Henderson v. Mayor of New York, 92 U.S. 259, 273 (1875); Hines v. Davidowitz, 312 U.S. 52 (1941) and the Solicitor General's Brief in Hines v. Davidowitz,

p. 83 and J. W. Hampton v. U.S. (276 U.S. 394), at pp. 26-27.)

This Court recently held a uniform state tax unconstitutional because it affected this exclusive area. With the encouragement of the Solicitor General, this Court, in Japan Lines Ltd. v. County, supra, held:

> "Second, a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential. Foreign commerce is pre-eminently a matter of national concern. 'In international relations and with respect to foreign intercourse and trade, the people of the United States act through a single government with unified and adequate national power.' Board of Trustees v. United States, 289 U.S. 48, 59 (1933)."
> (Slip Opin. p. 13.)

The Solicitor General and the Petitioner accept the rule that Federal control over foreign commerce is more complete than over interstate commerce. But they apply the rule to only a portion of foreign commerce. They believe that the Federal power over foreign commerce is cut into two "parts." The "part" that involves the power to discriminate against foreign commerce, they believe, is exclusive (see Solicitor General's Brief p. 8).

On the other hand, they argue that the part of the Federal power involving discrimination

in favor of foreign commerce (and against interstate commerce) is not so exclusive. In fact, the Petitioner and Solicitor General argue that any State-enacted foreign preference is valid. They thereby imply that this "part" of foreign commerce is totally "non-exclusive."

But even the power to regulate interstate commerce requires some Federal exclusivity (Boston Stock Exchange v. State Tax Comm., supra).

The result is that the Petitioner and Solicitor General would create a new third category of exclusivity of Federal power over commerce. That third category (including the Federal power to benefit foreign commerce) would require even less Federal control than interstate commerce.

Despite this bifurcation of Congress' "exclusive" power to regulate foreign commerce, there is abundant authority for the proposition that the States can no more favor foreign commerce, than discourage it. Board of Trustees v. U.S., supra (cited with approval in Japan Lines Ltd. v. County, supra, at p. 13) states:

> "The control of importation does not rest with the State but with Congress." (289 U.S. at 59.)

And in discribing the character of the control, this Court stated:

> "The Congress may determine what articles may be imported into this country and the terms upon which importation is permitted." (289 U.S. at p. 57) (emphasis added).

Thus, the regulation of imports is exclusively Federal.

In making the argument that this is not true, the Solicitor General's office ignores its prior statements to the contrary. Even as early as 1928, the Solicitor General took the position that the power to enact tariff regulations was a regulation of foreign commerce which is exclusively Federal (see Solicitor General's Brief in J. W. Hampton v. U.S., supra, at pp. 26-28). [This same argument was made by the Solicitor General in 1933 in Board of Trustess v. U.S., supra (see Solicitor General's Brief therein at pp.).] Finally, in Japan Line Ltd v. County, supra, just last year, the Solicitor General's office argued:

> "This Court has held that a state tax or regulation that disadvantages interstate of foreign commerce simply because it is interstate or foreign interferes with the exclusive national authority to regulate such commerce. . . ." (Solicitor General's Brief in Japan Line Ltd. v. County, supra, at p. 19.)

The "half-exclusive" argument not only ignores the cases of this Court and the statement of the Solicitor General's Office, it also ignores the very nature of the tariff power. The power does not exist for foreign interests only (as Petitioner and Solicitor General assume). It exists for Americans, too.

As this Court said in Board of Trustees:

"The laying of duties is 'a common means of executing the power' [to regulate foreign commerce] [citation]. It has not been questioned that this power may be exerted by laying duties 'to counter-vail the regulations and restrictions of foreign nations' [citation]. And the Congress may, and undoubtedly does, in its tariff legislation consider the conditions of foreign trade in all its aspects and effects. Its requirements are not the less regulatory because they are not prohibitory or retaliatory. They embody the congressional conception of the extent to which regulation should go."
(289 U.S. at p. 58) (emphasis added).

Thus, the argument that the States can go "further" than federal regulations is both logically and legally absurd. Congress has the power to determine to what extent regulation should go, not the States. Congress has the power to retaliate or not; to protect or not; and to prohibit or not. The States do not have those powers. In short, Congress has the power to apply burdens ". . . selectively to encourage or discourage any importation. . . ." (Michelin Tire Corp. v. Wages, supra, at p. 286), not the States. (Also see Charleston & Western Carolina Railway Company v. Varnville Furniture Company, 237 U.S. 597, 604 (1915); Penna. v. Nelson, 350 U.S. 497, 504 (1956).)

The exclusivity of Congress' power to impose (or not to impose) duties in certain specific amounts is further supported by U.S. Const. Art. I, §10,

Cl. 2, prohibiting the States from imposing imposts or duties.

Contrary to the arguments presented by the Petitioner and the Solicitor General, the policies of the import-export clause do not only prohibit discouragement of foreign goods, but prohibit encouragement as well. In Michelin Tire Corp. v. Wages, supra, a nondiscriminatory property tax was held valid because,

"By definition such a tax does not fall on imports as such because of their place of origin. It cannot be used to create special protective tariffs or particular preferences for certain domestic goods, and it cannot be applied selectively to encourage or discourage any importation in a manner inconsistent with federal regulation." (423 U.S. at 286) (emphasis added).

The Petitioner's claim that Michelin Tire Corp. v. Wages, supra, stands for the proposition that the States may encourage importation is totally misplaced.

3. The Proper Conduct Of Foreign Affairs, Demands That the Federal Government Exercise Exclusive Authority Over Economic Regulation Of Imports.

It should be emphasized again that R. & T. §225 is not a tax. It is an exemption which is made narrow by several pre-conditions. Those conditions encourage certain acts to be carried out in foreign countries and in other states before the exemption will be given. (The Petitioner claims that such encouragement was never intended, but that statement does not erase the language of the statute.)

The Federal Government utilizes customs duties as its means of differentiating between foreign goods and domestic goods. It utilizes this power for many purposes:

a. To regulate foreign commerce (Preamble to the Tariff Act of 1930, 46 Stats. 497).

b. To protect domestic industry (Preamble to the Tariff Act of 1930, supra; The Trade Act of 1974, 19 U.S.C. §§2102, et seq.; also see collection of Presidential Proclamations in Appendix D).

c. To retaliate for acts by other countries (Board of Trustees v. U.S., supra,

at p. 58).

d. To equalize the cost of marketing foreign goods with domestic goods (19 U.S.C. 1303 and 1336).

When the Federal Government utilizes its tariff power, the level of tariffs must be uniform throughout the United States (U.S. Const. Art. I, §8, Cl. 1).

It is obvious that the area is extremely sensitive. A German company importing through an Eastern state may well object because a Japanese competitor receives an effective tariff reduction by importing through California. The effect is magnified when one remembers that the Petitioner and the Solicitor General are proposing that all of the States can make R. & T. §225 adjustments.

Pursuant to its power to lay duties, the Federal Government may choose to ". . . countervail the regulations or restrictions of foreign nations. . . ." (Board of Trustees v. U.S., supra, at p. 58.)

It is no wonder that this Court has repeatedly held that the Federal power to regulate foreign affairs is not subject to the concept of concurrent State jurisdiction (Hines v. Davidowitz, 312 U.S. 52, 63 (1941); U.S. v. Curtis-Wright, 299 U.S. 304, 315-320 (1936); U.S. v. Belmont, 301 U.S. 324, 331-332 (1937); Calif. Bankers Assoc. v. Shultz, 416 U.S. 21, 59 (1974); and MacKenzie v. Hare, 239 U.S. 306, 311 (1915)).

Clearly tariffs and distinctions between foreign and domestic goods are intertwined with international relations (see Board of Trustees v. U.S., supra, at p. 59). The argument that the States may be more "generous" than the Federal Government is no answer to the exclusive Federal power, because the Tariff Acts,

> ". . . embody the congressional conception of the extent to which regulation should go." (Board of Trustees v. U.S., supra, at p. 58) (emphasis added).

The concurring opinion by Mr. Justice Stewart (joined by Mr. Justice Brennan) in Zschernig v. Miller, 389 U.S. 429, 443 (1968) is particularly appropriate to this case:

> "The Solicitor General, as amicus curiae, says that the Government does not 'contend that the application of the Oregon escheat statute in the circumstances of this case unduly interferes with the United States' conduct of foreign relations.' But that is not the point. We deal here with the basic allocation of power between the States and the Nation. Resolution of so fundamental a constitutional issue cannot vary from day to day with the shifting winds at the State Department. Today, we are told, Oregon's statute does not conflict with the national interest. Tomorrow it may. But, however that may be, the fact remains that the conduct of OUR FOREIGN AFFAIRS IS ENTRUSTED UNDER THE CONSTITUTION TO THE

> NATIONAL GOVERNMENT, not to the probate courts of the several States."

The unavoidable conclusion from the decisions of this Court and from the prior statements of the United States Solicitor General is that the power to regulate imports is exclusively Federal.

As this Court stated in Buttfield v. Stranahan, 192 U.S. 471, 492-493 (1904) and Brolan v. United States, 236 U.S. 216, 218-219 (1915):

> ". . . it is not to be doubted that from the beginning Congress has exercised a plenary power in respect to the exclusion of merchandise brought from foreign countries; not alone directly by . . . embargo statutes, but indirectly, as a necessary result of provisions contained in tariff legislation." (Emphasis added) (also see U.S. v. 12 200 Ft. Reels, 413 U.S. 123, 126 (1972)).

In light of the repeated assertions of both this Court and the Solicitor General, it would be peculiar, indeed, to believe that Congress' power over tariff and import regulations is not complete and exclusive.

4. The Exclusive Authority of Congress (Board of Trustees v. U.S., Supra; and Buttfield v. Stranahan, Supra) and the Area Of Freedom From State Regulation (Boston Stock Exchange v. State Tax Comm., Supra) Are Not Decreased Because Of the Petitioner's Arguments Concerning the Purpose Of R. & T. §225.

As already pointed out, the Petitioner and the Solicitor General utilize confused reasoning to avoid this Court's ruling in Boston Stock Exchange v. State Tax Comm., supra. They point out that the discrimination in Boston Stock Exchange was deliberately created by the New York Legislature.

In an attempt to draw a distinction, the Petitioner and the Solicitor General state that the discrimination involved in R. & T. §225 does not benefit local business. The Petitioner and the Solicitor General apply the legislative purpose (benefitting local business) to the exemption, but not to the conditions for the exemption.

But the conditions of R. & T. §225 are part of the statute. R. & T. §225 requires the goods to be put through a complex pattern of foreign and interstate commerce before the exemption will be allowed. 11/ The Petitioner and the Solicitor

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11/ The property must be ". . . manufactured or produced, . . . (2) outside of the

(continued on p. 41)

General want to divide R. & T. §225 in half. They want this Court to ignore its conditions. They want this Court to validate R. & T. §225 on the ground that the words ". . . shall be exempt from taxation" embody a legislative purpose.

This unusual argument results in an unusual effect. If the legislative purpose of helping California's economy is applied only to some of the words of R. & T. §225, then there is no legislative purpose to support the rest.

The logical effect of the argument made by Petitioner and the Solicitor General is to assert that the conditions of R. & T. §225 have no purpose.

Those conditions, requiring certain extra-territorial acts, are regulatory. The California Court of Appeal pointed out that they regulate foreign and interstate commerce.

Perhaps regulations of commerce can be saved by having a health or safety purpose. To a lesser extent, economic purposes may be considered by this Court (see H. P. Hood & Sons v. DuMond, supra). But it seems absurd to attempt to avoid Boston Stock Exchange v. State Tax Comm. on the ground that the exemption "portion" of R. & T.

11/ (continued from previous page)

United States . . ." Then it must be ". . . brought into this state . . ." and it must be ". . . for transshipment out of this state. . . ." It must also be "for sale in the ordinary course of trade or business. . . ."

§225 has a purpose, but that the condition "portion" does not.

No health or safety purpose has ever been used to support R. & T. §225. If its purpose is economic, then it falls pursuant to Boston Stock Exchange. The Petitioner has not put R. & T. §225 in a better constitutional position by asserting that the exemption "portion" of the statute has a purpose and leaving this Court to imagine what purpose supports the condition "portion."

Not only does this line of argument leave the "conditions" of R. & T. §225 without any purpose, it also demonstrates that the new complete inventory exemption in California achieves the same purpose of R. & T. §225 without imposing extra-territorial conditions.

5. The Exclusive Authority Of Congress Over Import Regulations and the Area Of Freedom From State Regulation Can Be Maintained Without Using R. & T. §225's Complicated Conditions. At the Same Time the Economic Goal of the State Will Be Achieved.

The California State Legislature has now altered its tax structure relative to inventory. All inventory is now exempt from taxation (see Assembly Bill No. 66, supra). (Repayments of these taxes are now also being considered by the Legislature.) This solution to the constitutional

difficulties of R. & T. §225 demonstrates that the Legislature can achieve the purpose of exempting goods passing through the State, without imposing an array of involved extraterritorial conditions.

Another alternative, now in effect in several states, is to exempt goods which are in the process of any movement which begins or ends outside the state. 12/ In any case, virtually all of the statutes cited by Petitioner demonstrate that R. & T. §225's purposes could have been achieved by other means with less impact on foreign and interstate commerce.

These alternative methods, and the Petitioner's argument concerning the purpose of the extra-territorial conditions, do not help the Petitioner's case. They hurt it.

This Court has held that even if a statute does not regulate in an area reserved for exclusive Federal control, it may still be unconstitutional. In Pike v. Bruce Church, 397 U.S. 137 (1970) this Court held that if a statute regulates even-handedly to effectuve a legitimate public purpose,

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12/ These statutes are Conn. Gen. Stat. Ann. §12-95(a); Ill. Stat. Ann. Ch. 120, §500.21; Kan. Stat. Ann. §79-201(f); Ky. Rev. Stat. §132-095; N.C. Gen. Stat. §105-275(10) (1977 Supp.); and Wisc. Stat. Ann. §70.111 (West). Contrary to the argument made by the Petitioner regarding the Tariff Acts, the existence of these statutes does not help its case. They demonstrate how the job can be done properly.

and if its effects on interstate commerce are incidental, then the Court will look to see if the burden on commerce is excessive in relation to the local benefits. One of the criteria for determining whether the burden is excessive is whether the local purpose can be achieved by other means with a lesser impact on interstate activities. (Also see Raymond Motor Transp. v. Rice, 434 U.S. 429 (1978); and Philadelphia v. New Jersey, supra.)

This Court does not have to reach the burden question because (1) the regulation of imports is exclusively Federal, (2) R. & T. §225 does not regulate evenhandedly, and (3) the Petitioner's arguments raise a question as to whether the conditions of R. & T. §225 serve any purpose. But if it did reach the question of burdens, this Court has at hand six statutes which create no discrimination between forms of commerce with contacts out of the state. There are also many more with less impact on the regulation of imports.

R. & T. §225 stands out as perhaps the worst possible way to achieve the object intended.

The Court of Appeal recognized that fact, and attempted to prevent R. & T. §225's operation at the state level. The Legislature repealed it by implication. But now the Petitioner wants this Court to validate it, not only to serve its own interests, but also to stand as an example for all 50 States.

6. Petitioner Cannot Avoid Boston Stock Exchange, Board of Trustees, and Buttfield v. Stranahan By Changing Its Position Regarding the "Facts."

The Court of Appeal reviewed R. & T. §225 in the context of the facts before it. Those facts included the existence of two streams of commerce, one foreign, the other interstate (see 85 Cal. App. 3d at p. 768, 149 Cal. Rptr. at 754). (The evidence also demonstrated that some foreign goods would be taxed under R. & T. §225 while others would not.)[13/] The state court's task was to determine

[13/] Foreign commerce, involving goods which are eventually sold to in-state customers, is taxed. Foreign commerce, involving goods which are eventually sold to out-of-state customers, is not taxed. The arbitrary conditions of R. & T. §225 create an exception in this latter category. Even though the goods are sold to out-of-state customers, they will be taxed if they are even partially "manufactured" in California. As can be seen from the map on page 13a and this discussion, the conditions of R. & T. §225 create a confusing array of preferences.

If this Court does not accept the determination of the Court of Appeal as to discrimination against interstate commerce, and if this Court determines that any additional facts are required, it is respectfully requested that this case be remanded for the taking of evidence on the existence of any discrimination.

the interpretation and logical effects of R. & T. §225.

The Petitioner urged the Court of Appeal to adopt a broad interpretation of R. & T. §225. But the Petitioner did not refute the facts before that Court; did not object to consolidating the case with Zee Toys; and did not object on the ground that the evidence was insufficient. The Petitioner only assumed that the amount of interstate traffic through California was small (see Pet. Brief below pp. 47-48).

Now the Petitioner attempts to "pull the rug" out from under the state court. The Petitioner argues that there is "no" evidence of discrimination.

But it is too late for the Petitioner's contention. Where a state court has determined that an effect of a state statute exists, this Court has held such determination to be conclusive. As this Court said in American Oil Co. v. Neill, supra, at pp. 455-456 (1965) and Gurley v. Rhoden, supra, at p. 208 (1975):

> "When a state court has made its own definitive determination as to the operating incidence, our task is simplified. We give this finding great weight in determining the natural effect of a statute, and if it is consistent with the statute's reasonable interpretation it will be deemed conclusive." (Emphasis added.) 14/

14/ The Petitioner may wish to rely on Diamond National Corp. v. State Board, 425 U.S. 268 (1976)

(continued on p. 47)

The Petitioner's new position regarding the facts should not be accepted because,

(a) Even if there were no stream of interstate commerce, R. & T. §225 would still present to the world a non-uniform tariff schedule (U.S. Const. Art. I, §8, Cl. 1); would prevent the Nation from speaking with one voice regarding tariff protection (Board of Trustees v. U.S., supra); and would discourage interstate manufacturers from even starting an interstate stream of commerce (H. P. Hood & Sons v. DuMond, supra, at p. 535).

14/ (continued from previous page)

and the case upon which it relies, i.e. Society for Savings, etc. v. Bowers, 349 U.S. 143 (1955). But in those cases, the taxpayer claimed federal immunity as an arm of the Federal Government pursuant to a Federal statute. Here (and in American Oil and Gurley), the Petitioner makes no such claim.

(b) The Court of Appeal found that there is a substantial stream of interstate commerce. The Petitioner should not be able to alter its position so as to embarrass that finding. 14a/

(c) The Commerce Clause "protects out-of-state businesses from any discriminatory burden on their interstate commerce activities," even an "inhibition" (Boston Stock Exchange v. State Tax Comm., supra, at p. 334, fn. 13).

14a/ The Court of Appeal also ruled that (1) the Respondents had standing to raise constitutional issues (2) the exemption could not be expanded to make it constitutional. Both of those holdings are supported by independent state grounds (see Respondents' Response to Pet. for Hearing before the California Supreme Court) and were not raised before this Court.

7. The Petitioner Cannot Avoid Boston Stock Exchange, Board of Trustees and Buttfield v. Stranahan By Contending That a Federal Statute Or a Constitutional Immunity From Taxation Is Consistent With R. & T. §225.

The Petitioner and the Solicitor General make three related arguments:

(a) Without once referring to Federal tariffs on goods, the Petitioner and Solicitor General's Office refer to Federal statutes exempting air flights coming from or going to foreign countries (Pet. Brief pp. 8 and 18; Solicitor General's Brief pp. 13-14).

But the exercise of its power to regulate foreign commerce cannot make the Federal power over foreign commerce less exclusive (see concerning opinion by Justice Stewart in Zchernig v. Miller, supra, at p. 433).

In any case, the Federal statutes do not apply to taxes on goods. Tariffs do. Finally, R. & T. §225 is not consistent with these statutes. The Federal statutes exempt all flights coming into the United States from abroad, even if they stop and unload in California. R. & T. §225 creates a preference only if the foreign goods move on.

(b) The Petitioner and the Solicitor General argue that Japan Line Ltd. v. County established

a foreign preference for foreign international carriers, and, therefore, any state may enact preferences for foreign goods.

Even if Japan Line Ltd v. County, supra (which provides a conditional immunity), is the harbinger of a total immunity for everything foreign (as Amicus Star-Kist suggests), it does not follow that the States may enact 50 different degrees of foreign preferences. Nor does it mean that the States can distinguish between foreign manufacturers on the basis of where they sell their goods.

(c) Finally, the Petitioner and the Solicitor General contend that R. & T. §225 (and 49 similar regulations) allow the Nation to speak with one voice in conducting foreign affairs. They then assume that compliance with the import-export clause validates R. & T. §225 under the commerce clause.

The second assumption is obviously incorrect.

The argument that R. & T. §225 allows the Nation to speak with one voice is valid if one ignores every single protective tariff; every single Presidential proclamation raising tariffs to protect domestic industry; and the decisions in Board of Trustees v. U.S., supra, and Buttfield v. Strahanan, supra. But these indications of protective purposes and Federal exclusivity will not go away.

8. Petitioner Cannot Make Import Regulation Less Exclusively Federal By Its De Minimus Argument. In Any Case, R. & T. §225 Has the Effect Of Decreasing Certain Tariff Schedules By 50% Or More.

The Petitioner ignores the impact of such regulations being enacted by several states and contends that a 1/2% difference between foreign and domestic goods is not large enough to consider. (The difference can be as high as 1 3/4%) (see Pet. Brief p. 23).

But, in Boston Stock Exchange v. State Tax Comm., supra, this Court considered a tax difference amounting to .19% as significant (429 U.S. at p. 334). As pointed out in connection with Petitioner's "fact" argument, Boston Stock Exchange also holds that even without direct monetary payments, out-of-state manufacturers are protected from the inhibiting effects of discriminatory regulations (429 U.S. at p. 334, fn. 13).

Further, Congress has enacted tariff levels in the range of 0 - 3% ad valorem. (See Appendix C.) Compared with a duty of 1%, the 1/2% difference created by R. & T. §225 is substantial.

Finally, the Executive Branch has altered tariffs in amounts of 1/2%, even when a 2% change was requested (see Appendix E herein).

9. The Application Of Boston Stock Exch., Buttfield v. Strahanan and Board of Trustees Is Further Supported By Other Holdings By This Court.

Certain state acts are prohibited under the commerce clause. The following prohibitions apply here:

(a) R. & T. §225 acts on goods only temporarily in the state so as to impose pricing preferences in other states. Projecting pricing regulations is prohibited (Baldwin v. Seelig, 294 U.S. 511, 521 (1935); Rottschaeffer, Handbook of American Constitutional Law, pp. 320 and 322, 1939).

(b) R. & T. §225 discriminatorily restricts the re-entry of interstate goods (and "manufactured" foreign goods) into interstate commerce. Such restrictions are prohibited (H. P. Hood & Sons v. DuMond, supra, at p. 539).

(c) R. & T. §225 effectively creates a selective tariff by discriminating between foreign goods. Tariffs must be uniform (Art. I, §8, Cl. 1).

10. R. & T. §225 Is Not Valid Because It Attempted to Comport With the Original Package Doctrine As Interpreted Before 1976.

R. & T. §225 was drafted in response to the problems of a particular interest group. 15/ It may have attempted to correspond to the then existing interpretation of the original package doctrine, but failed (see Solicitor General's Brief p. 10, fn. 5).

The Petitioner relies on First Federal S. & L. Assoc. v. State Tax Comm., 437 U.S. 255 (1978), for the proposition that the California Legislature's intent will validate R. & T. §225. First Federal S. & L. v. State Tax Comm., supra, does not stand for any such proposition. In fact, other holdings by this Court indicate that a state regulation must be reviewed under the circumstances prevailing at the time of the review. Georgia v. Rachel, 384 U.S. 780, 785 (1966). This is logical. To allow a state regulation to stand even though clearly invalid under the present state of the law, would undermine every single ruling of this Court and every single Federal statute.

15/ Contrary to the Petitioner's description of the history of the statute, that group's concerns were already aleviated (see R. & T. §233 and Respondents' Response to Petition for Writ of Certiorari p. 3).

The Supremacy Clause makes the constitution, as interpreted by this Court, the supreme law of the land. There is no authority for saying that this rule stops as of 1975.

The Court of Appeal attempted to stop the operation of this statute at the state level. The Legislature repealed it by implication (and is considering refunding these taxes). Using the "ghost" of R. & T. §225 to allow the States to countervail Federal policy regarding foreign commerce is not supportable.

III
THE VARIOUS FEDERAL ACTS SETTING AND REVISING TARIFF LEVELS PRECLUDES STATE ACTION IN THE SAME AREA.

A. The Tariff Acts Show the Necessity For Exclusive Congressional Authority In the Field Of Import Regulation.

There is no doubt that with some exceptions (Japan Lines Ltd. v. County, supra), the States have the authority to regulate the movement of imported goods and to tax them alike with domestic products. But when the State regulates between foreign and interstate goods, because they are either foreign or interstate, such State action is not valid.

As this same Solicitor General said only one year ago:

> "This Court has held that a state tax or regulation that disadvantages interstate or foreign commerce simply because it is interstate or foreign commerce interferes with the exclusive national authority to regulate such commerce. . . ." (See Solicitor General's Brief in Japan Lines Ltd. v. County, supra, at p. 19.)

There is good reason to accept the Solicitor General's statements in this matter. As already pointed out, the treatment of foreign goods vis-a-vis domestic goods is part of our foreign policy (see Board of Trustees v. U.S., supra, at p. 58). It is an extremely sensitive field and requires a determination of the precise extent that domestic goods are to be favored over foreign goods.

Not only should Congress be the exclusive regulator of this sensitive subject, but it has filled the subject to overflowing with a whole panolply of regulations. Specifically, it has imposed, and is constantly tinkering with, a whole set of ad valorem preferences for domestic goods imposed by means of customs duties.

Both the need for exclusivity and the pre-emption of all similar State activity is demonstrated by this Federal activity.

B. Both the Tariff Acts and the Rulings Of This Court Show the Extent Of Federal Activity Creating a Balance Between U.S. and Foreign Goods For a Host Of Purposes.

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1. The Basic Thrust Of Many Of the Tariff Provisions Is to Protect Domestic Industry From Foreign Goods By Equalizing Costs.

Title 19 U.S.C. §§1303 and 1336 protect domestic goods from foreign competition selling at reduced prices. This particular type of protection is probably the basis for most of the tariff schedules (19 U.S.C. §1202).

Of course, the Tariff Act of 1930 specifically announces its intent to act as a protector of domestic industry:

> "CHAP 497. - An Act to provide revenue, to regulate commerce with foreign countries, to encourage the industries of the United States, to protect American Labor, and for other purposes." (46 Stats. C. 497.)

2. The Anti-Dumping Provisions Of Title 19 U.S.C. and the "Trigger Price Mechanism" Provide Further Protection to Domestic Industry By Investigations Of Sales Below Certain Prices.

Title 19 U.S.C. §§160, et seq. protects domestic products from competition by foreign producers selling (or likely to sell) at a price less than at "fair value."

The "trigger price mechanism" (described at 42 F.R. 65214) creates a special set of prices for steel products. If foreign steel is sold for less than those prices, a hearing by the Treasury Department is automatically "triggered." The purpose of the hearing is to determine whether "dumping" has taken place.

3. The President Is Empowered to Raise Tariffs In Order to Countervail Discrimination By Other Foreign Countries Against American Exports.

Title 19 U.S.C. §1338 describes various situations calling for Presidential action in order to deal with various discriminatory acts of other countries. Those discriminatory acts range from discrimination directly against U.S. goods to the

conferring of benefits on third countries. 16/

Using tariffs to counteract various regulations of foreign countries is explicitly countenanced by this Court in Board of Trustees v. U.S., supra, at p. 58 (see quote, supra). In addition, ". . . Congress may and undoubtedly does, in its tariff legislation consider the conditions of foreign trade in all its aspects and effects."

4. In Addition, Congress Has Authorized the President to Protect American Industry By the Imposition Of Additional Tariffs (the Trade Act of 1974).

The President has by proclamation increased tariffs in order to protect domestic industry. These tariffs do not equalize costs. They counteract the threat to domestic manufacturers. (See Appendix D.)

These actions, their protective purpose, and the qualifying circumstances are all set forth at 19 U.S.C. §2253 (also see 19 U.S.C. §1351(a)).

16/ It is interesting to note that in applying these rules, Congress refers to commercial regulations imposed by a foreign country, including its subdivisions (19 U.S.C. §1338(i)).

C. Revenue and Taxation Code §225 Invades This Exclusive Area Of the Federal Government, and Is Excluded By the Complete Scheme Of Federal Regulation.

1. R. & T. §225 Acts as an Exception to the Federal Government's "System" Of Protection.

Contrasted with all of these protective purposes, R. & T. §225, deducts from the present tariff rates a variable amount up to 1-3/4% (in this case averaging 1/2%) (see Pet. Brief p. 23. The variation has nothing to do with national policy, but only to do with the "turnover" rate at the California warehouse.

The Federal Government protects domestic industry and labor by low tariff rates as well as higher ones. Many of the foreign goods are subjected to 1% rates (see Appendix C). Appendix E shows that the Federal Government is interested in ad valorem amounts of 1/2%.

But R. & T. §225 would cut across those differences variably. Sustaining this statute would allow all 50 states to enact similar legislation.

The Federal Government, as long ago as 1928, had created a system of protecting domestic industry. In J. W. Hampton & Co. v. U.S., 276 U.S. 394, this Court approved that purpose. It also said,

"The enactment and enforcement of a number of customs revenue laws drawn with a motive of maintaining a system of protection since the revenue law of 1789 are matters of history."
(276 U.S. at p. 411.)

The basis for such a protection system is UNIFORMITY. That uniformity is required by U.S. Const. Art. I, §8, Cl. 1, and is carried out by the Treasury Department pursuant to 19 U.S.C. §1502(a).

But R. & T. §225 is not protective, it is not uniform, and it selectively (out of state destinations vs. in-state destination) and variably (depending upon time in the state) favors foreign goods over interstate goods. 17/

2. The Federal Scheme Is So Pervasive That There Is a Reasonable Inference That Congress Intended Tariff Regulations to Be Exclusive.

R. & T. §225 is precluded by the "protective system" for a host of reasons. The general rules

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17/ The Federal system involving exports is not quite so apparent because no American government can tax exports as such (U.S. Const. Art. I, §9, Cl. 5). In fact R. & T. §225, by choosing between exports, has this effect.

applicable to this set of circumstances are set forth in Ray v. Atlantic Richfield Company, 435 U.S. 151 (1978). The first rule is that the state regulation is invalid if the Federal scheme is pervasive.

The tariff statutes and regulations, and the decisions of this Court concerning tariffs, demonstrate the exclusivity of the tariff regulations. This Court has so held in Board of Trustees v. U.S., supra, at pp. 56-57; Buttfield v. Stranahan, supra, at p. 492; and Brolan v. U.S., supra, at p. 218.

Congress' power to regulate foreign commerce by differentiating between imports and domestic goods has been used to its full extent and embodies a total system. The States may not interfere.

3. Distinguishing Between Foreign and Domestic Goods Is a Field In Which the Federal Interest Is So Dominant That State Regulations On the Same Subject Are Assumed to Be Precluded.

The second test, the application of which invalidates R. & T. §225, is the nature of the Federal interest. As already pointed out, this Court and the Solicitor General have repeatedly pointed to foreign affairs as an extremely sensitive subject requiring Federal control (see e.g. Hines v. Davidowitz, supra).

R. & T. §225 exempts some foreign goods, but not all. Its effects, in relationship to domestic goods, are VARIABLE, depending upon the amount of time the goods stay in the jurisdiction. It also discriminates against foreign producers operating in this country (because their goods are interstate, not foreign).

To allow all 50 States to enact legislation regulating imports would effectively take control of this sensitive area out of Federal hands. This area must not be placed in chaos as the Petitioner suggests.

4. The Objects and Obligations Of the Tariffs Acts Reveal a Purpose to Be Exclusive.

As this Court said in Board of Trustees v. U.S., supra, tariffs are an embodiment of Congress' view as to the extent of regulation between domestic and foreign goods. The object is to apply the precise amount of such regulation and no more. The object is accomplished by an ad valorem duty.

The object of tariff regulations and the manner in which they are achieved demonstrates the exclusivity of Federal control. It is no wonder that this Court has said that the Federal power in this field is "plenary" (Buttfield v. Strenahan, supra, and Brolan v. U.S., supra).

Thus, the objects and obligations of the Tariff Acts reveal an exclusive scheme.

5. R. & T. §225 Stands As an Obstacle to the Accomplishment Of the Full Purposes Of the Congressional Objective.

The final test described in Ray v. ARCO is that the state regulation will be declared invalid if it stands as an obstacle to the accomplishment of the purpose of the Federal regulation.

The Federal Government protects American industry by setting up tariff regulations in precise amounts. But R. & T. §225 changes that level of protection.

The Federal Government encourages a foreign producer to enter the American market, but only to a limited extent. R. & T. §225 provides more encouragement.

The Federal Government protects American producers so that they can successfully compete in interstate commerce. R. & T. §225 reduces this protection and discourages the American producer from participating in interstate commerce.

Even before shipment takes place these producers must consider the effects of R. & T. §225 and similar statutes on them. Foreign producers must consider the effect of selling to California customers, or of having their goods

painted before being sent to out-of-state customers. American producers must consider the added cost of avoiding the state tax which is not imposed on their foreign competitors.

In 1832 South Carolina enacted an "Ordinance of Nullification," which purported to nullify Federal tariff statutes insofar as they applied in the state (see The Federalist, Paul Leicester Ford, Editor, 1898, pp. 690-692). (The ordinance was, apparently, never enforced by the state.)

Now the Petitioner seeks to validate a statute which partially nullifies protective tariffs. R. & T. §225 is no more constitutional than the South Carolina ordinance.

As this Court recently said,

> "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." (Japan Line Ltd. v. County, supra, slip opin. at p. 19.)

Despite the new position of the Solicitor General, R. & T. §225 cuts into the exclusive Federal power to regulate commerce. R. & T. §225 is in direct conflict with protective tariffs. It destroys Federal uniformity in an area where uniformity is both important and constitutionally required.

It is respectfully submitted that none of the arguments presented by the Petitioner or the

Solicitor General allows the States to impose their own views of foreign and interstate commerce on goods temporarily within their borders. To allow all of the States to impose such regulations would effectively end Federal control of import regulations. State exemptions which are not uniform, which are variable, and which carry out only a State's perception of foreign commerce go too far. They invite chaos in our dealings with foreign nations.

Respectfully submitted,

JOHN H. LARSON
Dounty Counsel

JAMES DEXTER CLARK
Deputy County Counsel

Attorneys for Respondents

APPENDIX A

225. **Personalty in transit.** Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.

History.—Added by Stats. 1975, Ch. 1128, p. 2746, in effect January 1, 1976. Sec. 4 thereof provided no payment by state to local governments because of this act.

APPENDIX B

EXCERPTS FROM "CONDITIONS OF COMPETITION IN THE WESTERN U.S. STEEL MARKET BETWEEN CERTAIN DOMESTIC AND FOREIGN STEEL PRODUCTS" U.S. INT'L TRADE COMM PUB #1004 SEPTEMBER 1979

123

Foreign Investment in Western States 1/

Foreign investment in steel-related producing, fabricating, importing, distributing, and consuming firms in the Western States is small but growing. A total of 200 firms, accounting

---

1/ "Ownership" or "control" for purposes of this discussion means ownership of 50 percent of more of the outstanding voting stock. However, it must be noted that in many cases the owner of substantially less than 50 percent of the shares of a corporation may have effective control of the corporation. As a general rule, the more widely held a stock is the lower the percentage of shares required for control. In this regard, it should also be noted that the U.S. Department of Commerce considers a business enterprise to be foreign controlled where 25 percent or more of the voting shares are beneficially foreign held. Only one of the firms responding affirmatively to the question of foreign investment indicated that the level of foreign investment in the firm was less than 50 percent.

firms, accounting for about $28 billion in sales, responded to the Commission's investment questionnaire. As of January 1, 1978, 28 of these firms were owned by foreign firms or affiliates of foreign firms, while another 3, although U.S.-owned, can be considered to be controlled by foreign interests owing to their financial obligations to such foreign firms. 2/

Investment by Japanese-affiliated firms in the Western marketing region is, by far, the most prevalent.

* * *

In 1976 these firms had sales of 2 percent of total sales of firms responding to the questionnaire.

Canada is the only other country having substantial investments in Western States steel-related firms. In 1976, six firms with Canadian interests had sales of 2 percent of total sales of firms reporting to the Commission. Countries other than Japan and Canada having investments in the Western States are primarily the United Kingdom, Taiwan, Italy, and Korea.

2/ This control by lenders encompassed formal agreements restricting management activity in such areas as payment of dividends, maintenance of minimum net worth, disposition and assignment of proceeds from accounts receivable, limitation on new debt obligations, and acquisition of additional steel for inventory.

The time frame in which foreign investments in Western States steel-related firms have occurred is shown in the following tabulation:

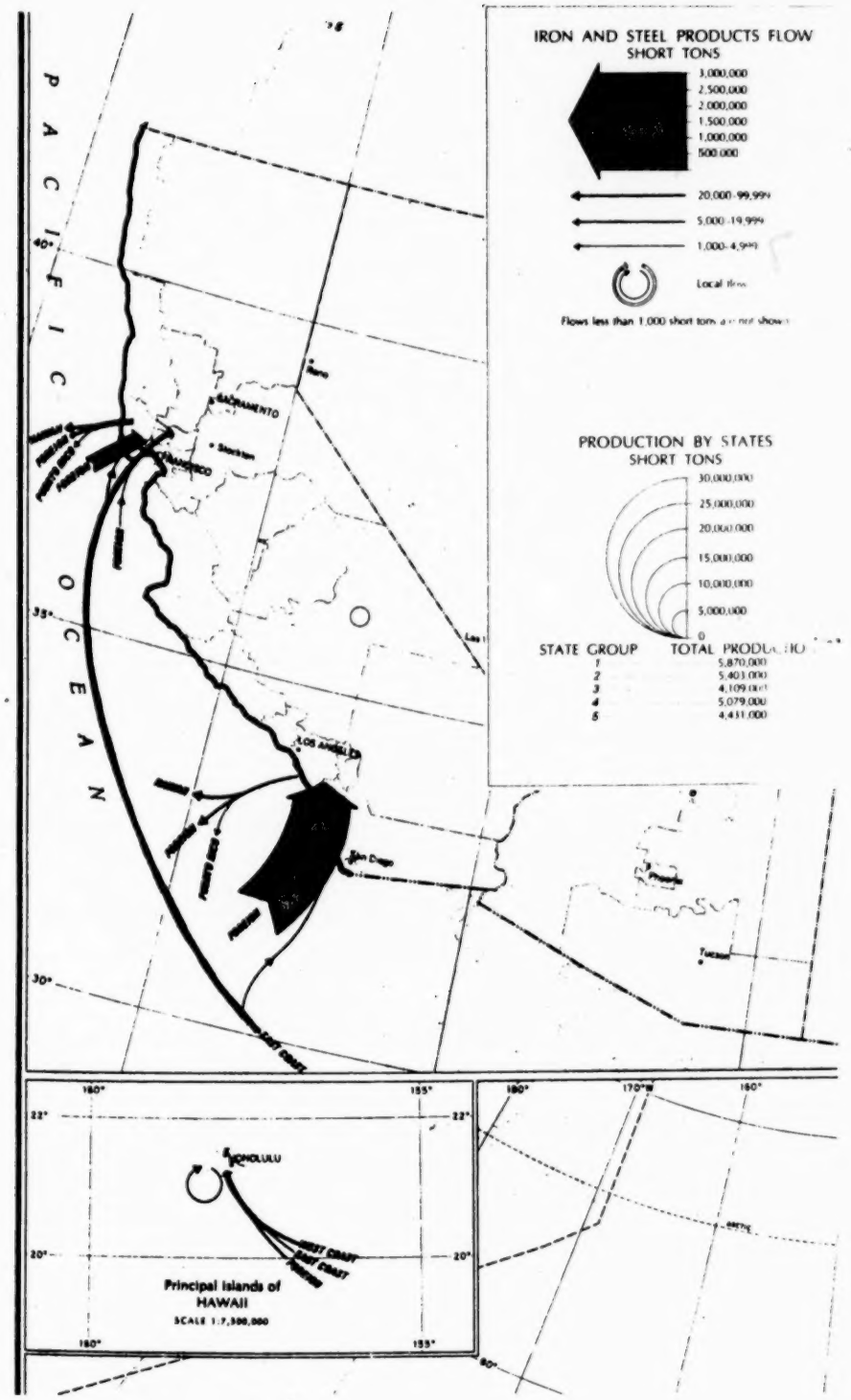
Country	1972 and before	1973-75	1976-77	Total
Japan	5	5	5	15
Canada	3	1	2	6
Other	5	2	3	10
Total	13	8	10	31

These data indicate that foreign investment is occurring at an accelerated rate--two-thirds of the firms in which Japan has interests were acquired in the past 5 years, and one-half of the firms in which Canada and other countries have interests were acquired during this same period.

On the basis of field research and trade sources, it appears that the reasons foreign investment has occurred in the Western States depend upon the steel sector involved and the time frame in which the foreign investment was made. In the distribution sector of the market, the acquired firms were generally importers dependent primarily upon Japanese sources for steel supplies. Foreign investments were directly linked to excess inventories of high-priced foreign steel purchased during the steel shortage of 1973 and early 1974. The weakness of demand and depressed prices in 1975 caused cash flow problems among domestic firms, which led to difficulties in their meeting accounts-payable obligations to foreign suppliers. In all cases, foreign investment in the distribution sector during 1975 was made by the foreign

supplier of a financially weak debtor.

In contrast to that in the distribution sector, foreign investment in the producing and consuming markets has resulted from the desire of U.S. firms to secure a broader capital base from which to expand an already successful business. Generally, these investments were in response to initiatives made by U.S. firms after their attempts to obtain participation by other U.S. firms had failed.



APPENDIX C

EXCERPTS FROM 19 USC § 1202

Advanced Aconite, etc.
(Item 435.10) .....1.5% ad val

Advanced Natural Drugs
(Item 439.30) .....1.5% ad val

Agricultural hand tools of cast-iron hatters' irons (Item 651.45...1.5% ad val

Animal substances, crude
(Item 191,15) .....2.5% ad val

Architectural sand plans used as designs for floor coverings, etc (Item 273.50) .....1.5% ad val

Artificial Graphite
(Item 517.11) .....2.5% ad val

Boxwood, Japanese maple and Japanese white oak
(Item 202.38) .....1.0% ad val

Cast iron pipe and tube fittings (Item 610.65) .....3.0% ad val

Cast malleable iron boot or shoe plates (Item 652.06).....2.5% ad val

Cements, not specially provided for (Item 494.60) .....2.5% ad val

Confectioners' coatings
(Item 156.47) .....2.5% ad val

Coral and cameos (jewelry)
(Item 741.15) .....2.5% ad val

Coarse-grained earthenware or stoneware chiefly used for preparing, serving, or storing food
(Item 533.11) .....2.5% ad val

Crystalline Graphite lump
(Item 517.27) .....2.5% ad val

Edible meat offal valued over 20 cents per pound
(Item 106.85) .....2.5% ad val

Fish roe boiled and in airtight containers (Item 113.35) .....2.5% ad val

Frogs (Item 106.60) .....2.5% ad val

Frozen Blueberries
(Item 146.68) .....3.0% ad val

Hydroids, treated and dyed for ornamental use (Item 190.57) .....2.5% ad val

Ink powers (Item 474.20) .....2.0% ad val

Laminated Paperboard
(Item 251.45) .....2.5% ad val

Mattress Hair (Item 186.40) .....2.0% ad val

Mica untrimmed phlogopite
(Item 516.11) .....2.5% ad val

Millstones of natural corundum (Item 519.95) .....2.5% ad val

Natural Hormones not artificially mixed
(Item 437.58) .....2.0% ad val

Natural Vitamins not artificially mixed (Item 437.84) .....2.0% ad val

Other Bovine (Item 120.17) .....2.0% ad val

Other Inks (Item 474.26) ..... 2.0% ad val

Other Wheat (Item 131.75) .....2.5% ad val

Other Willow (Item 222.25) .....2.5% ad val

Photography Papers (Item 252.05) .....1.0% ad val

Piles not cold worked (Item 620.40) .....3.0% ad val

Plain Softwood (Item 200.91).....2.5% ad val

Printed catalogs (Item 270.45).....1.5% ad val

Printed matter susceptible of authorship (Item 274.85) .....2.0% ad val

Slabs not rubbed and not polished in whole or in part (Item 514.61)...2.5% ad val

Standard Pine moldings (Item 202.62) .....1.5% ad val

Wild rice, crude or processed (Item 182.70) ..... 2.5% ad val

X-ray apparatus, other (Item 709.63) .....2.5% ad val

Yachts valued not over $15,000 (Item 696.05) .....2.0% ad val

APPENDIX D

SELECTED PRESIDENTIAL PROCLAMATIONS AND TARIFF SCHEDULES FROM 1974 to 1978

1. Ad valorem increases by the President to protect domestic industry:

   a. No. 4279 of April 1, 1974, 39 F.R. 11861 (Pres. Nixon) for Ball Bearings with rates varying from 11 to 20% ad val.

   b. No. 4436 of April 30, 1976, 41 F.R. 18397 (Pres. Ford) for Ceramic tableware with rates varying from 14 to 55% ad val.

   c. No. 4510 of June 22, 1977, 42 F.R. 32430 (Pres. Carter) for certain Footwear with rates varying from 6 to 86% ad val.

   d. No. 4538 of Nov. 11, 1977, 42 F.R. 59037 (Pres. Carter) for Sugar with a rate of 50% ad val.

   e. No. 4547 of Jan. 20, 1978, 43 F.R. 3251 (Pres. Carter) for Sugar with a rate of 50% ad val. limitation.

   f. No. 4561 of April 7, 1978, 43 F.R. 15127 (Pres. Carter) for Citizens Band (CB) Radio Transceivers with rates varying from 6 to 35% ad val.

g. No. 4608 of Nov. 15, 1978, 43 F.R. 53701 (Pres. Carter) for High-Carbon Ferrochromium with increases on the column 1 rate of 30% ad valorem in the first year declining to 20% ad valorem in the fifth year of relief.

h. No. 4631 of Dec. 28, 1978, 44 F.R. 1 (Pres. Carter) for Sugar with a rate of 50% ad val. limitation.

APPENDIX E

Ad Valorem Tariff on Lead To Be Cut From 4% to 3.5%

WASHINGTON — Special Trade Representative Reubin Askew has agreed to reduce to 3.5 percent the 4 percent ad valorem tariff on the lead due to take effect Jan. 1, following negotiations with the Lead-Zinc Producers Committee and United States lead consumers.

But the reduction is not as severe as the 2 percent cut that a coalition of domestic consumers had sought (AMM, Nov. 9).

A source in the trade representative's office said the decision to reduce the tariff has been made, although final document on the lowered tariff has not been signed yet. He noted that the consumers were probably still displeased with the 3.5 percent tariff.

Max Turnipseed, manager of international trade affairs for Ethyl Corp., spearheaded the consumer group, which included ESB Ray-O-Vac Corp., Philadelphia; Hammond Lead Products, Hammond, Ind.; Globe-Union Inc., Milwaukee; Gould Inc., Rolling Meadows, Ill., and Prestolite Co., Toledo.

Article from AMERICAN METAL MARKET,
Thursday Nov. 29, 1979
(Vol 87, No. 232), page 2

FOR ARGUMENT

Supreme Court, U.S.
FILED
JAN 5 1980
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES AND CITY OF COMPTON,

Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

PETITIONER'S REPLY BRIEF.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

PETITIONER'S REPLY BRIEF.

Preliminary Statement.

Respondents' Brief (hereinafter "Res. Br.") constitutes an aggregate of numerous disparate assertions. Many of these assertions are unsupported and many distort the decisions of this Court, particularly *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977). Some of the assertions are irrelevant and others grossly misstate Petitioner's position. Petitioner will not attempt to discuss all of Respondents' claims, but instead will focus upon the principal areas of controversy.

Respondents point out, as Petitioner did in its brief (Pet. Br. 5), that effective with the 1980 tax year California has exempted all inventories from property

tax. Respondents also note that a bill has been introduced to refund prior years' taxes which are at issue under the statute in question (Res. Br. 3-4).

A provision of the California Constitution, Article XVI, Sec. 6, prohibits the legislature from making gifts of public money. In a long line of cases commencing with *In Re Stanford's Estate*, 126 Cal. 112, 58 Pac. 462 (1899), the California Supreme Court has held that this provision is applicable to accrued tax liabilities.[1] Thus, if the taxes involved herein are held valid, the legislature cannot refund them. Respondents' suggestion that the state may order a refund is erroneous.

Since the exemption of all inventories will not take effect until the 1980 tax year, the statute in question will remain in effect for four taxable years—1976, 1977, 1978 and 1979. The resolution of this case is thus of importance to many California taxpayers. But of much greater importance is the fact that this case involves novel questions of constitutional interpretation, the resolution of which may eventually be of great importance to each of the fifty states and is presently of substantial importance to some thirty-six states having free port laws.

I

The Preference Shown by California's Property Tax Law to Foreign Goods Does Not Violate the Commerce Clause.

The main thrust of Respondents' argument is that California's tax exemption for imported goods sold in

[1] *Estate of Skinker*, 47 Cal.2d 290, 296, 303 P.2d 745, 748 (1956); *Texas Co. v. County of Los Angeles*, 52 Cal.2d 55, 338 P.2d 440 (1959); *Forster Shipbuilding Co. v. County of Los Angeles*, 54 Cal.2d 450, 6 Cal.Rptr. 24 (1960).

other states impermissibly touches upon foreign commerce (Res. Br. 32 *et seq.*). However, cases decided by this Court, including some of those relied upon by Respondents, have recognized that a state statute that does not interfere with federal policy and does not have a significant adverse impact upon federal power to regulate foreign commerce will not be held to violate the Commerce Clause. Exclusive federal regulation is mandated only where uniform national treatment of an aspect of commerce is required.

A. Section 225 Should Not Be Invalidated Under the Commerce Clause Since It Does Not Have a Significant Adverse Effect Upon the Federal Government's Power to Regulate Foreign Commerce.

Prior to the decision in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), state property tax laws could have virtually no effect upon foreign commerce inasmuch as imports still in their original packages were wholly immune from state property taxation. By abolishing the original package doctrine and approving state property taxes on imported goods, *Michelin* made it inevitable that the different state property tax laws would have differing impacts upon imported goods. *Michelin* thus indicates that state property taxation of foreign goods at rest in the taxing jurisdiction does not necessitate a uniform national rule and is not "of such a nature as to require exclusive legislation by Congress." *Cooley v. Board of Wardens of Port of Philadelphia*, 53 U.S. (12 How.) 299, 319 (1852).

Respondents rely on certain language in the *Michelin* decision for the proposition that the Commerce Clause flatly prohibits encouragement as well as discouragement of the importation of foreign goods (Res. Br. 34-35). It is highly doubtful as a factual matter, and

there is no evidence in the record to support the argument, that Section 225 has the effect of increasing the aggregate amount of importation into the United States. If it accomplishes anything, Section 225 probably causes importers who have used California facilities in the past to remain in the state rather than relocate and divert their imports to another state having more favorable tax laws. California thus appears to be competing with other states only for a share of existing import business. Competition of this type was expressly sanctioned by the Court in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 336-37 (1977).

Respondents have attempted to twist the *Michelin* decision holding that States *may* tax imports still in their original packages into a positive rule that States *must* tax such imports if other goods are taxed. *Michelin* simply does not require such taxation.

Even where a state statute has some impact on foreign commerce, it will not be invalidated absent an examination of the federal interest involved and the degree of state interference resulting from the statute. In *Bob-Lo Excursion Co. v. Michigan*, 333 U.S. 28 (1947), a Michigan law affecting foreign commerce was upheld because it was found that no national interest or policy affecting relations with foreign nations was adversely affected. In *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978), a case heavily relied upon by Respondents, the Court rejected an assertion that a Washington statute interfered with the federal government's authority to regulate foreign commerce and conduct foreign affairs on the grounds that the statute had "insignificant international consequences." 435 U.S. at 180.

The required inquiry into the extent of any asserted interference by a state statute with federal power to regulate foreign affairs is demonstrated through a comparison of *Zschernig v. Miller*, 389 U.S. 429 (1968), a case relied upon by Respondents, with *Clark v. Allen*, 331 U.S. 503 (1947), a case Respondents have ignored. In both cases, the Court considered the constitutionality of state inheritance statutes dealing with the rights of foreign nationals to inherit property. The Court upheld the California inheritance statute at issue in *Clark v. Allen*, but struck the Oregon statute involved in *Zschernig v. Miller*.

The Court in *Zschernig* found that the Oregon statute led into minute inquiries by state courts into the administration of foreign law, the credibility of foreign diplomatic statements and other matters of speculation for the state courts. The Court in *Zschernig* contrasted *Clark v. Allen* on the grounds that in that case only an incidental or indirect effect in foreign countries resulted.

In determining whether Section 225 interferes with the federal government's power to regulate foreign commerce, it is necessary to inquire whether the California statute has a significant adverse effect that violates federal policies. As discussed at pages 18-19 of Petitioner's opening brief, the California statute fully serves the policies animating the Commerce Clause.

Respondents rely upon *Japan Line, Ltd. v. County of Los Angeles*, 60 L.Ed.2d 336 (1979), for the proposition that Section 225 impairs federal uniformity in an area where it is essential (Res. Br. 31). In determining whether the state tax statute at issue in *Japan Line* was valid, the Court scrutinized the effect of the statute to see whether it interfered with any

of the policies requiring federal control over the area of foreign commerce involved. 60 L.Ed.2d at 346-51. The Court did not invalidate the state statute simply because it touched upon foreign commerce. Rather, the statute was held unconstitutional because it created the possibility of embarrassment to this country and retaliation by foreign countries.[2]

The concerns expressed in *Japan Line* over state action in certain spheres of foreign commerce are especially absent where foreign commerce is relieved of local burdens as provided in Section 225. If anything, the California statute ameliorates the concerns expressed in *Japan Line*.

B. The Cases Relied Upon by Respondents Are Inapposite.

In Petitioner's opening brief, *Boston Stock Exchange*, was analyzed in detail (Pet. Br. 14-18). Respondents offer little of substance in response (Res. Br. 40-41). In *Boston Stock Exchange*, the Court applied classic Commerce Clause principles to preclude New York from discriminating against interstate commerce as a means of benefiting local commerce. New York attempted to use its power to tax an in-state

---

[2]Respondents have attempted to show that the United States has taken a position in this case inconsistent with its position in *Japan Line*. (*E.g.*, Res. Br. 33, 54). However, the Brief for the United States in *Japan Line* made it clear that state statutes affecting foreign commerce should be upheld unless they interfere with federal policy or adversely affect an aspect of foreign commerce that requires uniform national treatment. See Brief for the United States, *Japan Line, Ltd. v. County of Los Angeles, supra*, at 5, 7, 9 and 22. The very language quoted by Respondents from page 19 of the Brief for the United States in *Japan Line* shows that the concern of the government has been with state statutes that treat foreign commerce *disadvantageously*. Thus, the position of the United States in the instant case is entirely consistent with its position in *Japan Line*.

operation (the transfer of stock) as a means of requiring that another transaction be performed in the home state (the sale of stock).

In contrast, California's statute imposes no such coercion. The exemption does not require a taxpayer to perform other operations in California as a condition for favorable tax treatment. If imported goods in the process of transshipment are in California on the tax lien date, they are entitled to the exemption. Nothing more is required.

Respondents have relied upon numerous decisions of this Court invalidating state statutes which employed discriminatory means in order to benefit local economic interests at the expense of interstate commerce.

In *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), a New York statute required dealers to pay minimum prices to milk producers. The Court held that the effect of the statute was to suppress competition and create an economic barrier against competition by products of other states. Applying traditional Commerce Clause analysis, the statute was invalidated.

H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949), another case relied upon by Respondents, involved New York's denial of a license to a Massachusetts milk distributor, thereby precluding the distributor from establishing a milk receiving station in New York. The Court found that the denial of the license had the effect of reducing competition and protecting local economic interests. Such a suppression of competition was held to constitute a violation of the Commerce Clause.

Likewise, in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), an Arizona statute required that cantaloupes

grown in the state be packaged within Arizona before being shipped to other states. The Court held that the statute created an unlawful burden on interstate commerce by requiring business operations to be performed in the home state that might be more efficiently performed elsewhere.

Hood, Baldwin, and *Pike* are similar to *Boston Stock Exchange* and distinguishable from the instant case. Here, no suppression of competition results from the statute. Further, the essential element in those cases—discrimination as a method to benefit local interests and exclude outside interests—is absent here.

II
Section 225 Does Not Operate to Offset Tariffs.

Respondents argue and the Court of Appeal found that Section 225 has the effect of offsetting tariffs. (Pet. for Cert., App. at 15-16). Respondents claim that a property tax exemption limited to imported goods reduces tariffs with respect to such goods and thereby diminishes the protection intended by Congress in enacting the tariffs.

A. Section 225 Preserves the Amount of Tariff Protection in Effect for Domestic Goods.

For more than one hundred years prior to the *Michelin* decision, imported goods such as those involved in this case were immune from property tax. During this period Congress enacted the Tariff Acts referred to by Respondents and thus set the levels of tariff protection while imported goods were immune from property tax. After the *Michelin* decision, states were permitted to impose property taxes upon imported goods that had historically been immune.

By enacting Section 225, however, California by statute exempted imported goods that generally had been immune from tax under the original package doctrine. Thus, Section 225 has the effect of preserving precisely the amount of tariff protection in existence prior to the *Michelin* decision and does not offset or reduce tariffs at all. Respondents' claim that Section 225 has the effect of reducing tariffs is erroneous. Section 225 has no such effect. Domestic manufacturers receive the same protection under Section 225 as they had historically received.

Although four years have passed since the *Michelin* decision, the federal government has not adjusted tariffs to take into account the additional costs imposed upon imported goods by reason of their being taxable by the states. As Petitioner suggested in its opening brief, it is likely that Congress ignores states' tax laws in setting tariffs (Pet. Br. 22).

B. The Laws of Each of Numerous Other States Create the Same Effect Respondents Claim Should Invalidate Section 225.

In addition to California, numerous other states have enacted free port laws. Like Section 225, these laws exempt imported goods held for shipment and sale in other states. However, unlike California, most free port laws also exempt goods from other states held for shipment and sale in third states. Like California, however, such states do not extend the exemption to locally manufactured goods held for shipment and sale outside the state.

If Section 225 were held invalid because it offsets the tariff protection intended for domestic manufacturers by taxing domestic goods while exempting im-

ports, then the free port laws of the other states should be held invalid for the same reason.

Respondents also refer to the tax laws of Connecticut and a number of other states (Res. Br. 43). These laws exempt all goods brought into the state as well as goods which are manufactured in the state and shipped out of the state in either interstate or foreign commerce. Goods manufactured and sold in the state, however, are taxable. By exempting imported goods sold within the state while taxing domestic goods manufactured and sold within the state, these laws have the same effect on tariff protection which Section 225 is alleged to have. Respondents, however, concede that these statutes are constitutional notwithstanding that they have the very effect which it is claimed invalidates Section 225 (Res. Br. 43 fn 12). How can it be held that the exemption accorded imported goods by Section 225 is invalid whereas the exemption accorded imported goods by Connecticut and the other states is valid?

C. The Interaction of the States' Diverse Property Tax Laws Inevitably Creates the Same Effect of Which Respondents Complain.

The laws of some states, such as New York, completely exempt business inventories from tax. These laws are clearly constitutional regardless of the effect they may have in other states. When goods imported through such a non-taxing state are offered for sale in other states in competition with domestically manufactured goods which have been taxed, the imported goods enjoy a competitive advantage over the domestic goods. This competitive advantage is precisely of the same kind and might well be in the same amount as the advantage accorded imported goods by Section 225.

The effect of Section 225 that Respondents claim is unconstitutional is the same effect that results from the interaction of differing state property tax laws upon goods that have been shipped between states. But so long as some states exempt all inventories or tax them at low rates, while others continue to tax inventories at higher rates, goods imported through the former group for sale in competition with goods shipped through the latter group will have the same type of advantage accorded imported goods by Section 225. The effect of which Respondents complain is an inevitable concomitant of a federal system in which states have autonomy, within broad limits, to fashion their own property tax laws.[3]

The only way to eliminate the competitive advantage which imported goods may gain over domestic goods as a result of differing state property tax laws is to supplant all such laws with a uniform property tax law applicable in all states. While uniformity of state tax systems may be desirable, this Court recently pointed out that Congress is the appropriate forum for such a decision. With respect to the effect of multistate

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[3]Section 225 may relieve importers of a cost that may be incurred in the selling of goods but there are many costs with respect to importing and selling goods and many ways a state might reduce such costs in order to enhance its attractiveness as a commercial center. For example, in order to attract international trade California might construct a modern and efficient port and finance the cost through general revenue resources rather than user fees. Such action would benefit importers since they would make a proportionately greater use of the port facility while not bearing a proportionate share of its cost. The cost savings to importers resulting from such a state project would have no less an effect on tariffs than Section 225 or numerous other state programs. The direct effect Respondents suggest Section 225 has on tariffs is nothing more than an abstract and hypothetical consequence of a cost reduction.

taxation of income, the Court has recognized that risks of duplicative taxation exist whenever states have different rules concerning division of income. *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267 (1978). The Court there stated:

> ". . . Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State. The Constitution, however, is neutral with respect to the content of any uniform rule." 437 U.S. at 279.

III

Although Respondents Assert That Section 225 Is Discriminatory and Unconstitutional, the Statute Has No Apparent Effect Upon Commerce.

Respondents characterize the differential in the California property tax structure as "discrimination" or "regulation" (*E.g.,* Res. Br. 12, 20). However, unlike virtually all Commerce Clause cases involving discrimination, in which there was evidence that a party suffered an adverse impact or injury, in this case there has been no showing of injury to any party. The effects upon commerce which Respondents ascribe to Section 225 are speculative and abstract.

Having failed to prove the existence of a prohibited effect resulting from Section 225,[4] Respondents argue

[4]Respondents have improperly attempted to inject in this case a declaration from another case that there is a substantial stream of interstate commerce. (Res. Br. 24, 46, 47a). Such declaration was a part of the record in *Zee Toys, Inc. v. County of Los Angeles,* 85 Cal.App.3d 763, 149 Cal.Rptr. 750 (1978), which was consolidated for appeal purposes only with this case. The court below clearly treated the two actions as separate cases and discussed the facts involved separately. 85 Cal.App.3d at 766-69, 149 Cal.Rptr. at 752-54. All of the facts herein were stipulated by the parties, such stipulation was adopted by the trial court, and it was silent as to the existence of any effect of Section 225 upon commerce.

that it should be held unconstitutional without consideration of its effect (Res. Br. 28-30). For this proposition, Respondents rely upon cases involving discrimination in favor of local commerce and against interstate commerce. In such cases, statutes fostering local economic protectionism were said to be virtually *per se* unconstitutional. Unlike the statutes in those cases, Section 225 does not involve discrimination in favor of local commerce.

In *Philadelphia v. New Jersey,* 437 U.S. 617 (1978), the Court found that in discriminating against articles of commerce coming from outside the state in favor of articles originating within the state, New Jersey had erected a barrier against interstate commerce which had the effect of impermissibly isolating the state from the national economy.

The other cases relied upon by Respondents for the virtually *per se* test of unconstitutionality involved parochial statutes that suppressed competition by requiring business operations to be performed in the home state that could be more efficiently performed elsewhere. Such economic protectionism was the basis of the decisions in *Boston Stock Exchange, supra,* and *Pike v. Bruce Church, Inc., supra,* and it is conspicuously absent in the California tax structure. Thus, the virtually *per se* standard has no applicability in the instant case.

As pointed out in Petitioner's opening brief, it is necessary for Respondents to prove that Section 225

has an effect upon competition (Pet. Br. 26). Respondents have completely failed to address the fact that there has been no evidence that interstate and foreign goods shipped through California compete with one another in the same markets in other states.

Conclusion.

For the reasons set forth herein and in Petitioner's opening brief, the opinion of the California Court of Appeal, Second Appellate District, should be reversed.

Respectfully submitted,

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

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No. 78-1577

In the Supreme Court of the United States

OCTOBER TERM, 1979

SEARS, ROEBUCK AND CO., PETITIONER

v.

COUNTY OF LOS ANGELES AND CITY OF COMPTON

ON WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, SECOND APPELLATE DISTRICT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

WADE H. MCCREE, JR.
Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney
Department of Justice
Washington, D.C. 20530

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's invitation of June 4, 1979.

OPINIONS BELOW

The order of the trial court is not officially reported. The opinion of the Court of Appeal (Pet. App. 1-29) is reported at 85 Cal. App. 3d 763. The denial by the Supreme Court of California of a petition for hearing (Pet. 2) is reported at 149 Cal. Rptr. 764.

JURISDICTION

The decision of the Court of Appeal was entered on October 25, 1978 (Pet. 2; App. 1). The Supreme Court of California denied a petition for hearing on January 17, 1979 (Pet. 2). The petition for a writ of certiorari was filed on April 16, 1979 and was granted on October 1, 1979. The jurisdiction of this Court rests on 28 U.S.C. 1257(3).

QUESTION PRESENTED

The United States will discuss the following question:

Whether the California property tax exemption for personalty manufactured or produced (1) outside California and brought into the State for transshipment out of the United States; or (2) outside of the United States, and brought into California for transshipment out of the State, for sale in the ordinary course of trade or business, is invalid under the Commerce Clause of the United States Constitution.

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution provides: "The Congress shall have Power * * * To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

Sections 225 and 225.1 of the Cal. Rev. & Tax. Code (West), enacted by 1975 Cal. Stats., ch. 1126,

at 2746, §§ 1 and 2, during the period here involved,[1] provided as follows:

> § 225. *Personalty brought into state for transshipment outside state or United States; exemption*
>
> Personal property manufactured or produced, (1) outside this state and brought into this state for transshipment out of the United States, or (2) outside of the United States and brought into this state for transshipment out of this state, for sale in the ordinary course of trade or business shall be exempt from taxation. The exemption under this section shall not apply to personal property in manufacturing process or production. Such process or production shall not include the breaking in bulk, labeling, packaging, relabeling, or repackaging of such property.
>
> § 225.1. *Method of claiming transshipment exemption*
>
> A person claiming the transshipment exemption under Section 225 may either claim this exemption by (1) a percentage method of determining property held for transshipment on hand at a particular location by allocating a portion of the total inventory, using the percentage determined by dividing the total out-of-state shipments by the taxpayer from that location during the preceding year by the total of such shipments from that location during such year, or (2) an

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[1] Although Section 225.1 of the Cal. Rev. & Tax. Code (West) was repealed by 1977 Cal. Stats. ch. 246, § 4, its provisions were simultaneously reenacted as Section 253.10 of the Rev. & Tax. Code, by 1977 Cal. Stats., ch. 246, § 7.

actual method as evidenced by contracts of sale on the tax lien date, and a full, true and correct inventory of all property held for transshipment together with the date of receipt of the same, the date of withdrawal of the same, the point of origin thereof, and the point of ultimate destination thereof.

STATEMENT

Petitioner brought this suit in the Superior Court of Los Angeles County for refund of ad valorem personal property taxes paid under protest to the County of Los Angeles and the City of Compton.

The facts were stipulated (Pet. App. 1-2, 4) and may be summarized as follows: Petitioner is engaged in the business of selling goods at retail, both in California and elsewhere. On March 1, 1976, the tax lien date for purposes of the annual California ad valorem tax on personal property, petitioner held tangible personal property in warehouses in the County of Los Angeles and City of Compton. The property in question had been manufactured or produced outside the United States, and had been imported by petitioner and placed in warehouses for distribution both within and without California for purposes of sale in the ordinary course of petitioner's business (Pet. App. 1-2).

Petitioner's distribution warehouses in the County of Los Angeles were devoted almost entirely to goods imported from foreign countries, particularly from locations in the Pacific area. The rate of turnover at the warehouses was approximately three times

per year. Petitioner intended to ship the goods as quickly as its distribution operations permitted. Pursuant to Sections 225 and 225.1 of the California Revenue and Taxation Code, petitioner applied to the total amount of goods manufactured or produced outside the United States and held in its warehouses in Los Angeles County on March 1, 1976, the fraction represented by the out-of-state shipments from those locations during the preceding year divided by the total shipments from those locations during that year. Petitioner accordingly claimed a transshipment property tax exemption for property having a value of $19,373,089 (Pet. App. 1-3, 4-5).

Respondents denied the claimed exemption. They asserted (1) that properly construed, Section 225 exempted only goods in transit through the State, and (2) that even if Section 225 were construed to exempt imported goods held in the State by the owner for disposal or use, it would violate the United States Constitution by regulating interstate and foreign commerce and interfering with foreign affairs, because it extended no exemption to interstate goods. Petitioner thereupon paid the tax under protest and instituted this action for refund in the Superior Court of Los Angeles County. The Superior Court upheld petitioner's claimed exemption (Pet. App. 1-2, 5-6).

The Court of Appeal reversed (Pet. App. 29). Although it rejected respondents' statutory argument that Section 225 applied only to goods "in transit" (Pet. App. 7-10), it held that the statutory exemption of foreign goods regulated interstate and foreign

commerce and was therefore invalid under the Commerce Clause of the United States Constitution (Pet. App. 6, 10-18). It also suggested that the exemption interfered with the power of the Congress to impose tariffs (Pet. App. 15-16).

In the Court of Appeal's view, the statutory exemption gave goods of foreign origin a competitive advantage over goods manufactured in other states and brought to California for transshipment in interstate commerce. It concluded that "state taxes which discriminate between classes of interstate and foreign goods on the basis of their origin are not permitted" (Pet. App. 14). In further support of its conclusion, the Court of Appeal relied upon this Court's decision in *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977). The Court of Appeal observed that "[d]iscrimination between (1) interstate transactions and foreign transactions cannot be distinguished from (2) discrimination between two types of interstate transactions. Both interstate and foreign transactions are brought within the control of Congress by the same clause of the United States Constitution" (Pet. App. 15). With three Justices dissenting, the Supreme Court of California denied a petition for hearing (Pet. 2).

ARGUMENT

THE CALIFORNIA PROPERTY TAX EXEMPTION FOR FOREIGN GOODS DESTINED FOR INTERSTATE COMMERCE OR OUT-OF-STATE GOODS DESTINED FOR EXPORT DOES NOT VIOLATE THE COMMERCE CLAUSE

In holding that the California property tax exemption for foreign goods destined for interstate commerce or out-of-state goods destined for export violates the Commerce Clause of the Constitution and interferes with Congress' power to impose tariffs, the Court of Appeal misinterpreted the decisions of this Court.

1. Section 225 of the California Revenue and Taxation Code exempts from taxation while held in California, imported goods destined for other states and goods from other states destined for export. It does not, however, exempt domestic goods destined for interstate commerce. On the authority of this Court's decision in *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977), the Court of Appeal held that the statute unconstitutionally discriminated against interstate commerce and therefore violated the Commerce Clause.

But *Boston Stock Exchange* has no bearing on the question presented in this case. The prohibited discrimination at issue in that case was a New York transfer tax on the sale of securities that taxed transactions involving an out-of-state sale more heavily than most transactions involving a sale with-

in the state. As this Court held, that statute provided for taxation "in a manner that discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state business" (429 U.S. at 335).

Here, in contrast, the statutory property tax exemption did not favor local business at the expense of out-of-state business. It favored imports and exports.[2] There is, however, no constitutional prohibition against favoring imports over domestic goods. The Import-Export Clause of the Constitution itself makes such a differentiation. And the decisions of this Court have in various contexts held invalid state statutes that have had an adverse impact upon foreign nationals or upon foreign commerce.[3] Nor does the Commerce Clause require a different result. As this Court reaffirmed in *Washington Rev. Dept.* v.

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[2] See also *Allied Stores of Ohio* v. *Bowers*, 358 U.S. 522 (1959). There, the issue was addressed under the Equal Protection Clause of the Fourteenth Amendment rather than under the Commerce Clause. Compare *Wheeling Steel Corp.* v. *Glander*, 337 U.S. 562 (1949).

[3] See, *e.g.*, *Brown* v. *Maryland*, 25 U.S. (12 Wheat.) 419 (1827); *Henderson* v. *Mayor of New York*, 92 U.S. 259 (1875); *Chy Lung* v. *Freeman*, 92 U.S. 275 (1875); *People* v. *Compagnie Gen. Transatlantique*, 107 U.S. 59 (1882); *Asakura* v. *Seattle*, 265 U.S. 332 (1924); *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414 (1940); *Hines* v. *Davidowitz*, 312 U.S. 52 (1941); *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964); *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964); *Zschernig* v. *Miller*, 389 U.S. 429 (1968).

Stevedoring Ass'n, 435 U.S. 734, 751 (1978), "the Import-Export Clause states an absolute ban, whereas the Commerce Clause merely grants power to Congress." See also *Richfield Oil Corp.* v. *State Board*, 329 U.S. 69, 75 (1946).

When only the Commerce Clause is involved, this Court only last Term in *Japan Line, Ltd.* v. *County of Los Angeles*, No. 77-1378, (April 30, 1979), explicitly rejected the premise that "Commerce Clause analysis is identical, regardless of whether interstate or foreign commerce is involved. * * * When construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required" (slip op. 11-12). *Japan Line* held that shipping containers employed in foreign commerce, based and owned in Japan, were not subject to the apportioned property taxation to which domestic shipping containers engaged in interstate commerce would have been subject.[4] Although this Court in *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276 (1976), held that a state was not constitutionally required to exempt imports held in the original package from generally imposed property taxation, nothing in the decision suggested that the exemption that had previously been constitutionally

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[4] See *Ott* v. *Mississippi Barge Line*, 336 U.S. 169 (1949); *Braniff Airways* v. *Nebraska State Board*, 347 U.S. 590 (1959).

required under decisions overruled by *Michelin Tire* was thereafter constitutionally prohibited.

As the Court in *Michelin Tire* pointed out (423 U.S. at 283-294), the considerations underlying the Import-Export Clause were that the federal government speak with one voice in regulating commercial regulations with foreign governments, that import revenues not be diverted to the states, and that seaboard states with ports of entry not be permitted to be toll-takers at the expense of states not as favorably geographically situated. The California statute serves all of these purposes. The fact that it serves and advances constitutional policy somewhat more fully than the minimum required of the state [5] does not justify the Court of Appeal's ruling that it violates the Commerce Clause.

During the more than 100 years prior to the *Michelin Tire* decision, while the rule of *Low* v. *Austin*, 80 U.S. (13 Wall.) 29 (1871) and *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652 (1945), required exemption of imported goods in original packages

[5] Even before the *Michelin Tire* decision, the California exemption was somewhat broader than the minimum then constitutionally required. By its terms, the exemption for imports persisted beyond the original package, for it permitted breaking bulk, repackaging, etc. With regard to goods held for export, it granted exemption prior to movement in the stream of exportation, as defined by this Court's decisions in *Empresa Siderurgica* v. *Merced Co.*, 337 U.S. 154 (1949), and *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949. It is not questioned, however, that the goods exempted from tax were goods that had been imported and goods that were subsequently exported.

from generally imposed state property taxes, this Court consistently held that goods that had moved in interstate commerce in their original packages enjoyed no comparable exemption.[6] When the Court overruled *Low* and *Hooven* in *Michelin Tire*, it was not on the basis of any discrimination favoring imports over goods in interstate commerce, but only because the considerations that gave rise to the Import-Export Clause did not require exemption. Nothing in *Michelin Tire* suggested that the pre-existing exemption was now to be constitutionally prohibited.[7]

[6] *Woodruff* v. *Parham*, 75 U.S. (8 Wall.) 123 (1868); *Brown* v. *Houston*, 114 U.S. 622 (1885); *American Steel & Wire Co.* v. *Speed*, 192 U.S. 500 (1904); *Sonneborn Bros.* v. *Cureton*, 262 U.S. 506, 509, 510-513 (1923); *Wiloil Corp.* v. *Pennsylvania*, 294 U.S. 169 (1935).

[7] Indeed in contexts other than property taxes on goods in the original package, the Court has treated imports or exports markedly differently from goods shipped in interstate commerce. Compare *Dept. of Revenue* v. *James Beam Co.*, 377 U.S. 341 (1964) and *Hostetter* v. *Idlewild Liquor Corp.*, 377 U.S. 324 (1964) with *State Board* v. *Young's Market Co.*, 299 U.S. 59 (1936) and *Brewing Co.* v. *Liquor Comm'n*, 305 U.S. 391 (1939); *Crew Levick Co.* v. *Pennsylvania*, 245 U.S. 292 (1917) with *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250 (1938); *Carson Petroleum Co.* v. *Vial*, 279 U.S. 95 (1929) with *General Oil Co.* v. *Crain*, 209 U.S. 211 (1908), *Bacon* v. *Illinois*, 227 U.S. 504 (1913), and *Minnesota* v. *Blasius*, 290 U.S. 1 (1933).

Carson Petroleum Co. v. *Vial, supra*, may have been heavily qualified by the decision in *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949), as the dissent in the latter case asserted (337 U.S. at 291-292). But the result in *Carson Petroleum* was distinguished from other contemporary decisions principally by the fact that the oil involved was destined for export (see 279 U.S. at 106-109).

In sum, the decisions of this Court involving imports, exports, and foreign commerce uniformly emphasize that one of the principal purposes of the Constitution was to assure that the states did not impede or obstruct importation, exportation, or foreign commerce. The Court in *Michelin Tire* overruled *Low* v. *Austin* only when it was demonstrated that application of a generally imposed property tax to imports in the original package did not substantially impede importation or foreign commerce. *Washington Rev. Dept.* v. *Stevedoring Ass'n*, 435 U.S. 734, 751-755 (1978).

By favoring imports and exports, Section 225 of the California Revenue and Taxation Code facilitates importation and exportation and assures that imports and exports passing through the state will not be impeded even to the extent of the impact of a generally applicable property tax. While such action may not be constitutionally required, it is not, as the decision below erroneously held, constitutionally prohibited. Nothing in the Commerce Clause prevents a state from favoring imports and exports beyond the extent required by the Import-Export Clause.

2. In further support for its invalidation of the statutory exemption for imported goods, the Court of Appeal suggested (Pet. App. 15-16) that Section 225 impedes the power of the Congress to determine the effective tariff applicable to imported goods. But this reasoning is contrary to this Court's analysis in *Michelin Tire*. In considering the effect of removing the exemption for imported goods required by earlier

decisions, the Court pointed out (423 U.S. at 287): "It may be that such taxation could diminish federal impost revenues to the extent its economic burden may discourage purchase or importation of foreign goods. The prevention or avoidance of this incidental effect was not, however, even remotely an objective of the Framers in enacting the prohibition."

3. Furthermore, Sections 4271 and 4272 of the Internal Revenue Code of 1954 show that the California exemption for imports and exports is entirely consistent with congressional policy. Section 4271 imposes a tax of 5 percent upon the amount paid for transportation of property by air, but Section 4272 (a) limits this to "transportation by air which begins and ends in the United States." Section 4272(b) excludes from tax, under regulations prescribed by the Secretary, "transportation of property in the course of exportation * * * by continuous movement, and in due course so exported."

Under Treasury Temporary Regulations in Connection with the Airport and Airway Revenue Act of 1970 (26 C.F.R.), Section 154.2-1(c)(1) and (2), transportation will be considered to begin and end at the points of origin and destination as shown by a through airwaybill, or, if no such airwaybill has been issued, then the export or import character of the shipment may be shown by a contract or other written evidence showing the beginning point and ending point of air transportation. And Section 154.2-1(c)(1) of the Regulations is explicit in providing that transportation from a point outside the United States

to a point inside the United States will not be considered broken "even though there may be stopovers in the United States (such as, for example, to consolidate cargo at a 'gateway' city)."

With regard to exports, the tax is not applicable to the segment of air transportation in the United States even though the mode of transportation in export is other than by air. Section 154.2-1(d)(1) of the Regulations provides:

> For example, the tax does not apply to air transportation from Chicago to New York if the property is in the course of exportation, by continuous movement, by boat from New York to Europe and in due course is so exported. Delays caused by circumstances beyond the control of the shipper (such as labor disputes or natural disasters) will not interrupt continuous movement. Property arriving at a gateway city by air may be repacked or consolidated with other property without interrupting continuous movement.

Under Section 154.2-1(d)(3) of the Regulations, payment of the tax may be deferred for six months to establish the fact of export "in due course" within that period. Proof of export received after six months will establish a ground for refund of the tax paid.

The foregoing provisions show that even when the facilities of the airways of the United States are employed,[8] Congress has exempted from the air transportation excise tax goods that are in fact imports and exports, and has provided flexible rules permitting

[8] Cf. *Massachusetts* v. *United States*, 435 U.S. 444 (1978).

stopovers, repackaging, and consolidation of cargo in the course of movement without loss of exemption. California's removal of property tax burdens upon imports and exports in Section 225 is therefore entirely consistent with congressional policy.

CONCLUSION

The judgment of the Court of Appeal should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

M. CARR FERGUSON
Assistant Attorney General

STUART A. SMITH
Assistant to the Solicitor General

ERNEST J. BROWN
Attorney

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COUNTY OF LOS ANGELES and CITY OF COMPTON,

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On Petition for a Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

Motion for Leave to File Brief Amicus Curiae in Support of Petitioner and Brief of Charles R. Ajalat as Amicus Curiae in Support of Petitioner.

CHARLES R. AJALAT,
AJALAT & POLLEY,
523 West Sixth Street, Suite 552,
Los Angeles, Calif. 90014,
Amicus Curiae.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO.,

Petitioner,

vs.

COUNTY OF LOS ANGELES and CITY OF COMPTON,

Respondents.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

Motion for Leave to File Brief Amicus Curiae in Support of Petitioner.

Charles R. Ajalat, Ajalat & Polley, hereby respectfully moves for leave to file the attached brief amicus curiae in this case. The consent of the Attorney for the County of Los Angeles has been obtained. The consent of the Attorney for the Petitioner was requested and refused.

Charles R. Ajalat, Ajalat & Polley represents, in pending litigation, clients who have been denied the benefits of the statute whose constitutionality has been questioned. In addition to being an active practitioner in the state and local tax area, he teaches state and local taxation in the Masters of Taxation program

at the University of Southern California. He was involved in the passage of the statute here involved as well as all of the other California developments related to and leading up to *Michelin Tire Corp. v. Wages* (1976) 423 U.S. 276, 46 L.Ed.2d 495, 96 S.Ct. 535. For each of these reasons, he has an interest in the case at bar and the development of the law in this area.

Based on relatively extensive oral discussions with both parties, it is believed that the parties will not or have not sufficiently recognized the extent to which this case is an integral part of the important line of state tax cases decided by this Court since 1976 and its interrelationship with that line of cases. This case, too, involves the problem of the effect on interstate or foreign commerce of a state or local government decision to tax, or (as in this case) not to tax. Further, based on those discussions, it is believed that the parties will not or have not sufficiently set forth the purpose and effect of the statute whose constitutionality is questioned. Both of these considerations are relevant to a proper disposition of the case and to the development of federal constitutional law as it impacts on state and local taxation.

Charles R. Ajalat, Ajalat & Polley, therefore, urges that leave be granted to file a brief as amicus curiae and respectfully so moves the Court.

Respectfully submitted,

CHARLES R. AJALAT,
AJALAT & POLLEY,
Amicus Curiae.

BRIEF OF AMICUS CURIAE ON THE MERITS IN SUPPORT OF PETITIONER.

I.
INTEREST OF AMICUS CURIAE.

Amicus Curiae represents, in pending litigation, clients who have been denied the benefits of the statute whose constitutionality has been questioned. In addition to being an active practitioner in the state and local tax area, Amicus Curiae teaches state and local taxation in the Masters of Taxation program at the University of Southern California. Amicus Curiae was involved in the passage of the statute here involved as well as all of the other California developments related to and leading up to *Michelin Tire Corp. v. Wages* (1976) 423 U.S. 276, 46 L.Ed.2d 495, 96 S.Ct. 535. For each of these reasons, Amicus Curiae has an interest in the case at bar and the development of the law in this area.

II.
ARGUMENT.

This case is an integral part of the important line of state tax cases decided by this Court since 1976. It, too, involves the problem of the effect on interstate or foreign commerce of a state or local government decision to tax, or (as in this case) not to tax.

A. Michelin, Complete Auto, Japan Lines and the Case at Bar Should Establish a Coherent Interstate-Foreign Commerce Dichotomy.

In the last three years, this Court in an exciting and direct way has come to grips with the age old problems presented by state taxation which are at the same time some of the most difficult and some of the most important ones of our constitutional

framework. The Court is recognizing that the constitutional concepts cut across all the state tax lines and it is making a coherent, workable conceptual framework out of what has otherwise been chaos.

Nexus and apportionment in relation to benefit—the two key *due process* considerations—have long ago been set forth by this Court with recent affirmation: Nexus, having been broadly defined, is often no longer an issue (*but see National Geographic Society v. California Board of Equalization* (1977) 430 U.S. 551, 51 L.Ed.2d 631, 97 S.Ct. 1386); apportionment, although it still presents extremely difficult issues, especially in the income tax area (see *Moorman Manufacturing Co. v. Bair* (1978) 437 U.S. 267, 57 L.Ed. 2d 197, 98 S.Ct. 2340), has been deemed by the courts often to be best handled by the legislature.

Commerce Clause problems, on the other hand, have evolved somewhat more slowly in terms of solutions based on consistent, practical theories. Not until recently has the Court been able to come to grips with the application of state taxes to interstate commerce and foreign commerce other than to recognize that states could not discriminate against such commerce (recently reaffirmed in *Boston Stock Exchange v. State Tax Comm'n* (1977) 429 U.S. 318, 50 L.Ed.2d 514, 97 S.Ct. 599, and *Michelin Tire Corp. v. Wages, supra*).

The Court's first step toward making sense out of nondiscriminatory apportioned state taxation as it relates to interstate commerce and foreign commerce was the dramatic elimination of the Import-Export Clause as a separate consideration. (*Michelin Tire Corp. v. Wages, supra.*)

The Court then dealt with *interstate commerce* in terms of the modern realities and our strong federal

system and made the income tax rules conform, as they should, to the theory behind the property tax rules: Nondiscriminatory, properly apportioned taxes can be applied to all commerce between the states, including transactions exclusively in interstate commerce. (*Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 51 L.Ed.2d 326, 97 S.Ct. 1976.)

Finally, the Court turned its attention to the key problem of state taxation today—the effect of state and local taxes upon the relations of the sovereign federal government with other sovereign governments. Refusing to use the outdated and inconsistent "home port doctrine," the Court dealt with the key issue itself—the effect of state taxation upon *foreign commerce* and held that "When construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required." (*Japan Line, Ltd. v. County of Los Angeles* (1979) ..... U.S. ....., 60 L.Ed.2d 336, at 346, 99 S.Ct. .....)

The Court is now faced with clarifying the coherent structure it has erected in *Complete Auto* (interstate commerce) and *Japan Line* (foreign commerce). The vehicles before the Court are the case at bar and the pending cases of *Mobil Oil Corp. v. Vermont Com'r of Taxes* (No. 78-1201) and *Asarco Inc. v. Idaho State Tax Comm.* (No. 78-1839).[1] Unless the

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[1]The issues presented in this brief may not affect the pending *Mobil Oil* and *Asarco* cases, *supra,* unless the Court applies the "forbidden effect" test of *Complete Auto Transit, Inc. v. Brady, supra,* 51 L.Ed.2d at 337, or unless it overturns (as many have argued it should) the doctrine of *Flint v. Stone Tracy Co.* (1911) 220 U.S. 107, 55 L.Ed. 389, 31 S.Ct. 342. (See *Pacific Co. Ltd. v. Johnson* (1932) 285 U.S. 480, 76 L.Ed. 893, 52 S.Ct. 424), suggested by some to be the key remaining outdated anachronism in the state tax area after the elimination of the "original package" and "home port" doctrines.

Court is to go back to additional legal fictions and artificial distinctions, it must use the current term's cases to make clear that foreign commerce itself must have absolute immunity from state *taxation* under the foreign commerce clause,[2] and that state statutes furthering that goal, as in the present case, are valid and desirable.

Legal fictions and artificial distinctions, if they are adopted, will not only cause years of litigation and burdens on the courts, but will ultimately have to be swept away as were the original package doctrine in *Michelin,* the franchise tax-income tax distinction in *Complete Auto,* and the home port doctrine in *Japan Line.* The alternative is workable and consistent with the federal constitution prohibition of discrimination *against* foreign commerce. The alternative is to allow nondiscriminatory, properly apportioned state taxation of interstate commerce; to prohibit any state taxation of foreign commerce; and to allow states, consistent with the policies behind such prohibition, to favor foreign transactions over local and interstate ones, subject to the ultimate responsibility they owe in this regard to their electorates and the Congress.

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[2]For example, the *Japan Line* rule should not be limited solely to foreign based instrumentalities exclusively engaged in foreign commerce but should be applied to domestic based instrumentalities to the extent they are engaged in foreign commerce. Any reference to prohibiting taxation of foreign commerce, of course, would mean no expansion of the rules applicable where such foreign commerce has terminated. For example, foreign goods which are not in transit have no *constitutional* immunity. *Michelin Tire Corp. v. Wages, supra.*

B. Japan Line's Special Treatment of Foreign Commerce Applies to the Case at Bar.

Japan Line, Ltd. v. County of Los Angeles, supra, prohibited the taxing authority from taxing foreign based instrumentalities of commerce engaged exclusively in foreign commerce. This Court, noting that the argument was "not without weight," recognized appellee's concern that "by exempting appellant's containers from tax, the state in effect will be forced to discriminate against domestic, in favor of foreign commerce."

The case at bar is not one wherein the constitution *requires* a similar discrimination against domestic in favor of foreign commerce. Rather, the issue is whether the state legislative action must be upheld as properly consonant with the special place and protection from state *taxation* given foreign commerce by the federal government. Although *Japan Line* does not constitutionally require the result, the policies behind *Japan Line* require a holding that the statute is valid.

The proper analysis starts by recognizing that the *Japan Line* rationale must apply to foreign commerce generally and not to a particular aspect of such commerce. To avoid inconsistency and artificiality, the special treatment of foreign commerce granted in *Japan Line* cannot and must not be limited to instrumentalities of foreign commerce. Further, it must not be limited to foreign based domiciliaries, nor limited to exclusively foreign commerce (as opposed to the portion of a business which is in foreign commerce)

To limit *Japan Line* to instrumentalities of foreign commerce would be to say the vehicle that carries the commerce is more important than the commerce itself.[3] To limit the constitutional protection of foreign commerce to foreign based companies would be to create a non-intended constitutional discrimination against American based companies doing business in foreign commerce.

To hold that foreign commerce is special if it is engaged in exclusively, but when interstate commerce is also engaged in the constitutional immunity is lost, would be irrational.

The enhanced risk of multiple taxation test set forth in *Japan Line* applies whenever any aspect of foreign commerce is involved, especially in today's narrowing and interdependent world. "[N]either this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign." (*Japan Line, Ltd. v. County of Los Angeles, supra,* 60 L.Ed. 2d at 247.) If *foreign commerce* is involved and California can *tax* any aspect of it, it follows that foreign sovereigns would also have a theoretical basis to tax and its apportionment formula is not under the control of this Court or this Nation.

Japan Line also teaches that it must be inquired whether the *tax* prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments." (*Japan Line, Ltd. v. County of Los Angeles, supra,* 60 L.Ed.2d at 349.)

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[3]Compare *Japan Line, Ltd. v. County of Los Angeles, supra,* 60 L.Ed.2d at 349, fn. 14, "In Washington Revenue Dept., the Court, holding that the state tax at issue did not prevent 'speaking with one voice,' noted: 'No foreign *business* or vessel is taxed.' " (emphasis added).

The rationale for the inquiry is to prevent international disputes over reconciling apportionment formula and retaliation against the taxing state and other states of the United States.

As the Solicitor General in this case has said: "In sum, the decisions of this Court involving imports, exports, and foreign commerce uniformly emphasize that one of the principal purposes of the Constitution was to assure that the States did not impede or obstruct importation, exportation, or foreign commerce." (Brief of the United States as Amicus Curiae, p. 9.)

These policies apply to all aspects of foreign commerce and cannot be limited to instrumentalities that are foreign-owned and exclusively in foreign commerce. To not accept this principle will cause litigation, inconsistencies and impossible lines to draw for years to come.

If *Japan Line,* then, prohibits state taxation of foreign commerce because of the inability to control foreign taxation and the fact that state taxation can cause international disputes and retaliation, what does this teach us about state exemption of goods being transshipped through California which have a foreign source or foreign destination? Such state exemption does not involve the difficult problem of this Court or this Nation telling foreign sovereigns what to do. Such state exemption lessens rather than heightens the likelihood of international disputes and retaliation. Although an exemption of foreign commerce from certain countries would be prohibited, exemption of all foreign source or foreign destination transshipments is not only a valid state legislative power but one consonant with the foreign commerce policies behind the Commerce

Clause. Such a statute should be encouraged and not prohibited. California Revenue and Taxation Code Section 225 which lessens burdens on foreign source or foreign destination transshipments must be upheld as proper legislative action consonant with the special place and protection from state taxation given foreign commerce by the federal government.

C. The Statute Permissibly Discriminates in Favor of Foreign Transactions and Is Consistent With the Free Flow of Goods Between Sovereign Nations.

1. Boston Stock Exchange.

The California Court of Appeal held, based on *Boston Stock Exchange v. State Tax Comm'n, supra,* that Revenue and Taxation Code Section 225 unconstitutionally discriminated in favor of foreign commerce and against domestic commerce. We must recall again that the result of *Japan Line* appears to require "the state in effect . . . to discriminate against domestic in favor of foreign commerce." (See page 7 above.) Although there is no constitutional requirement of discrimination in the case at bar, as set forth above, the policies of *Japan Line* make clear that such a discrimination is not unconstitutional.

The *Boston Stock Exchange* case is not relevant to the case at bar because it was in the interstate context. It prohibited "a direct commercial advantage to local business" by reason of taxing "laws that favor local enterprises at the expense of out-of-state businesses." (429 U.S. at 329.) The discrimination "between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses" (*Id.* at 335(was prohibited because it went against the

policy of creating "an area of free trade among the several States." (*Id.* at 328.)

Where foreign transactions are involved, different considerations are at issue. As the Solicitor General made clear, there is no constitutional prohibition against favoring imports and exports over domestic goods. In fact, the Import-Export Clause makes such a differentiation, and does so as a matter of absolute prohibition against certain state taxes on imports or exports. The purpose of the Import-Export Clause—to assure a free flow of goods between sovereign nations and the inland states of this country—is precisely furthered by Revenue and Taxation Code Section 225.

This Court has never held that there could not be discriminations in *favor* of foreign commerce, but rather only prohibited discriminations against foreign commerce.

> "[T]he decisions of this Court involving imports, exports and foreign commerce uniformly emphasize that one of the principal purposes of the Constitution was to assure that the states did not impede or obstruct importation, exportation or foreign commerce. . . . [The statute] facilitates importation and exportation and assures that imports and exports passing through the state will not be impeded even to the extent of the impact of a generally applicable property tax. While such action may not be constitutionally required, it is not, as the decision below erroneously held, constitutionally prohibited. Nothing in the Commerce Clause prevents a state from favoring imports and exports beyond the extent required by the Import-Export Clause." (Brief for the United States as Amicus Curiae, pp. 9-10.)

2. Tariffs.

The Court of Appeal in the case at bar also held that the federal tariff power was undermined by the statute. As noted by the Solicitor General, the reasoning of *Michelin Tire Corp. v. Wages, supra,* holds this irrelevant. (423 U.S. at 287.) More importantly, it should be clear that state and local taxes do not impact tariff decisions inasmuch as it would be impossible administratively for the federal government to take into account all state and local taxation or non-taxation in determining tariff policy. To look at the thousands of cities, counties, states and special districts and the impact on foreign goods of nondiscriminatory, apportioned taxes where there was nexus in relationship to benefit; and then to determine the impact of nondiscriminatory decisions by other such entities not to tax; and then to keep track of all changes in the taxing policies of these thousands of entities, would be undesirable even if possible. Further, the statute in question clearly applies to imports and exports in the transportation stream from all countries and does not discriminate in favor of or against any nation.

3. Free Trade.

Of greater importance than the inapplicability of *Boston Stock Exchange* or relationship to tariffs is the effect of the statute in relationship to the key federal policy as to foreign commerce: free trade among sovereign nations absent specific Congressional decisions to the contrary.

With the modern interdependence of nations, the problems of balance of payments and the need of nations to encourage foreign purchases of their own goods, there is a strong impetus to make the flow

of goods between sovereign nations and the United States as unencumbered as possible *vis-à-vis the states.*

The statute clearly supports the flow of foreign trade with the United States. To prohibit the state legislature from advancing that trade would hurt the federal policy rather than help it. To not allow the states to take a position consonant with that of the federal government would be detrimental to the federal position. If Congress wished to encourage state furtherance of its policies, it would be required to pass statutes in every conceivable area asking for such aid, and a decision invalidating Revenue and Taxation Code Section 225 would make states wary of whether, notwithstanding general federal approval, this Court might change their statutes.

4. Responsibility to Their Electorates.

It must be noted that the major discrimination under Revenue and Taxation Code Section 225 is that *California* based manufacturers who export goods to foreign countries and import goods to California are not exempt, whereas their counterpart exporters or importers in Arizona are exempt.

In fact, California could not favor both foreign transshipments *and* local origination or destination transactions at the expense of interstate transactions, for the discrimination between the latter two would violate *Boston Stock Exchange.*

Thus, a strong, built-in check on the system exists in that the California legislature is responsible to the California electorate as to any favoring of foreign transshipments over other commerce. This factor would probably not be enough by itself to validate an interstate discrimination. When combined with the special status

of foreign commerce, with which the statute is consonant, however, it makes clearer that not only is free trade between sovereign nations furthered by the statute; but, there are built-in protections to prevent serious discrimination against interstate commerce.

5. Free Flow of Commerce to Inland States.

Rather than impede interstate commerce, it must be emphasized that the purpose of Revenue and Taxation Code Section 225, in consonance with the Import-Export Clause and the regulation of foreign commerce, was precisely to help the free flow of goods from foreign countries to the other states of the United States. Thus, not only is there encouragement of a free flow of goods between nations but between the states themselves.

III.
CONCLUSION.

For all of the foregoing reasons, Amicus Curiae urges this Court to reverse the California Court of Appeal and uphold the constitutionality of Revenue and Taxation Code Section 225.

Respectfully submitted,

CHARLES R. AJALAT,
AJALAT & POLLEY,
Amicus Curiae.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1978
No. 78-1577

Supreme Court, U.S.
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SEARS, ROEBUCK & CO., a corporation

Petitioner,

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Respondents.

Brief of Amicus Curiae Pioneer Electronics of America, Soundesign Western, Association of Electronic Importers, and Foreign Trade Association of Southern California, in Support of Petitioner Sears, Roebuck & Co.

GERALD T. MANPEARL

Attorney for Amicus Curiae

EVANS, MANPEARL & HARTER
Los Angeles World Trade Center
350 South Figueroa Street, Suite 900
Los Angeles, California 90071
(213) 488-0545

and

KENT TEN BRINK
6476 San Marco Circle
Los Angeles, California 90068
(213) 463-5444

Of Counsel

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GERALD T. MANPEARL

Attorney for Amicus Curiae

EVANS, MANPEARL & HARTER
Los Angeles World Trade Center
350 South Figueroa Street, Suite 900
Los Angeles, California 90071
(213) 488-0545

and

KENT TEN BRINK
6476 San Marco Circle
Los Angeles, California 90068
(213) 463-5444

Of Counsel

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IN THE
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SEARS, ROEBUCK & CO., a corporation,

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Brief of Amicus Curiae Pioneer Electronics of America, Soundesign Western, Association of Electronic Importers, and Foreign Trade Association of Southern California, in Support of Petitioner Sears, Roebuck & Co.

INTEREST OF AMICUS

Pioneer Electronics of America, Soundesign Western, the Association of Electronic Importers, and the Foreign Trade Association of Southern California hereby respectfully file this Brief Amicus Curiae in support of Petitioner Sears, Roebuck & Co. and consent of both parties was obtained by the attorneys for Amicus Curiae and

are attachted hereto as Appendices A and B.

Pioneer Electronics of America and Soundesign Western are domestic corporations importing goods into the State of California, a substantial portion of which is transshipped out of the State, and transshipment exemptions under California Revenue and Taxation Code Section 225 have been claimed, and are pending before the courts of the State of California. These claims are dependent upon the outcome of this case.

Amicus Curiae Association of Electronic Importers is a California corporation consisting of electronic importers, all of whom have inventories in the State of California, transshipped a portion of such inventories out of the State, and fall within the provisions of Revenue and Taxation Code Section 225.

Amicus Curiae Foreign Trade Association of Southern California is a nonprofit association of more than 460 importers, exporters and service firms engaged in international trade and vitally interested in the impact and effect this litigation has had and will have on the importing industry and international trade.

Attorneys for Amicus Curiae represent the above corporations and numerous companies that have claimed transshipment exemptions under the provisions of California Revenue and Taxation Code Section 225 and have lawsuits pending against the County of Los Angeles for recovery of exemptions which have been denied. Said attorneys are

familiar with all of the issues, briefs and facts in this case, and represented Zee Toys, the companion case to Sears, Roebuck & Co. v. County of Los Angeles.

QUESTION PRESENTED

Whether California Revenue and Taxation Code Section 225, in granting a property tax exemption to imported inventories no longer in transit, but inteded for transshipment out of the State of California, regulates interstate and foreign commerce and thereby violates the Commerce Clause of the United States Constitution.

SUMMARY OF ARGUMENT

1. The purpose of the Commerce Clause is to prevent states from discriminating against interstate or foreign commerce in favor of local business or commercial interests. Exempting certain classes of inventory does not provide any commercial advantage to a local business in violation of the Commerce Clause purposes.

2. For a state tax statute or regulation to be found unconstitutional under the Commerce Clause there must be an affirmative showing that it has burdened commerce in a manner violating the intent and purposes of the Commerce Clause. The court in the instant case has merely assumed or speculated that there was a burden because a

distinction, classification, or discrimination existed.

3. The use of a per se test to determine constitutionality of a statute under the Commerce Clause has been rejected by this Court. Reliance by the court in Zee Toys on Boston Stock Exchange v. State Comm'r., 429 U.S. 318 (1977) is misplaced.

4. There is no constitutional impediment to classifying types of goods for different tax treatment. A state may constitutionally tax some goods and exempt others based on the type of goods involved, their manner of manufacture or even their place of origin. Such distinctions are constitutional so long as the state has not attempted to discriminate against interstate or foreign businesses.

ARGUMENT

A. THE CALIFORNIA COURT OF APPEAL HAS NOT PROPERLY APPLIED THE COMMERCE CLAUSE.

The California Court of Appeal held that California's free port or transshipment law, Revenue and Taxation Code Section 225, violated the Commerce Clause of the U.S. Constitution. The basis of the court's holding was that an exemption was provided for goods imported

from foreign countries, but not similarly provided to goods imported from other states. This, reasoned the court, constituted a discrimination and a burden on interstate commerce, an inpermissible regulation of foreign commerce, and an interference with the federal government's pattern of imposing import duties.

In reaching this decision the court has misconstrued the purposes of the Commerce Clause. It should be noted that the goods in the instant case were no longer in foreign commerce or in interstate commerce. They were unloaded from vehicles of transportation and placed in warehouses for storage pending subsequent transshipment to retail stores, and were subject to the state's power to impose a nondiscriminatory ad valorem property tax. Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976). Unlike Michelin, the question is not whether the state can tax such goods, but whether it must tax such goods, together with other inventory in the state. It should also be noted that Section 225 does not distinguish between local business and interstate or foreign businesses: each is entitled to the exemption to the extent it deals in foreign goods. Section 225 is merely a classification statute; granting an exemption to certain types of goods and denying it to other types of goods.

The purpose of the Commerce Clause is to see that states do not discriminate against interstate or foreign commerce by giving local businesses commercial advantage over out-of-state businesses. (See, e.g., H. P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 538-539

(1949).) In Japan Lines, Ltd. v. County of Los Angeles, ___ U.S. ___, 60 L.Ed.2d 336 (1979), the Court noted that in regard to foreign commerce the Import-Export Clause and Commerce Clause had similar policies: (1) to permit the federal government to speak with one voice in commercial relations with foreign governments; (2) to prevent the states from diverting revenues from the federal treasury to their own treasuries; and (3) to prevent port states from exacting unreasonable tolls to the rest of the country. None of those policies are violated by an exemption statute as opposed to a tax.

As distinguished from Japan Lines, in the instant case there was no evidence of any adverse or potential effect on interstate or foreign commerce. To the contrary, Section 225 by providing an exemption would not provide any risk of retaliation from foreign countries, but invites reciprocity of tax treatment for United States exports.

In McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33, 48 (1940) the Court held that the law under the Commerce Clause had been fashioned by the Court in an effort to "'. . . reconcile competing constitutional demands, that commerce between the states shall not be unduly impeded by state action, and that the power to lay taxes for the support of state government shall not be unduly curtailed.'" The balance between the competing demands of state interests and the constitutional requirements of the Commerce Clause have been accomplished by upholding taxes designed to make interstate commerce bear a reasonable share of the cost of local government,

and "by invalidating those which discriminate against interstate commerce, which impose a levy for the privilege of doing it, which impose an undue burden on it." (American Smelting, Etc. Co. v. County of Contra Costa, 271 Cal. App. 2d 437, 77 Cal. Rptr. 570 (1969).)

The instant case does not discriminate, but merely supplies an exemption. The principal purpose of the Commerce Clause, to prevent states from obstructing foreign and interstate commerce, has not been abused. While a tax can burden foreign commerce and obstruct commercial intercourse, a tax exemption has no such effect. The error of the court in the instant case was its failure to make a fundamental analysis of a state regulation which places no undue burden on commercial is established. The test in any event must be whether or not the distinction created by the statute creates an undue risk of burden to interstate or foreign commerce. When relations with foreign governments are involved, an added test is whether the tax or regulation under consideration will prevent the federal government from speaking with a single voice. (Japan Lines, Inc. v. County of Los Angeles, supra.) Neither of these criteria are threatened in the instant case.

Before a state statute or regulation can be declared unconstitutional under the Commerce Clause, it must be shown to have burdened the commerce involved, whether it is interstate or foreign commerce. (See, Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64, 69 (1963).) In McGoldrick v. Berwind-White Coal Mining Co.,

supra, at 45, the Court stated: "It is only when the tax operates to regulate commerce between the states or with foreign nations to an extent which infringes the authority conferred upon Congress, that the tax can be said to exceed constitutional limitation. [citations]"

By contrast to Halliburton, Japan Lines and McGoldrick, the Zee Toys court made no showing of a burden on commerce. Instead, the court held that there was a "discrimination" and applied a per se test.

The use of a per se test in the instant case is in contrast to the modern trend of decisions allowing greater latitude to states in instituting their taxing policies. (See, Michelin Tire Corp. v. Wages, supra; Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).)

In Washington Revenue Dept. v. Association of Washington Stevedoring Companies, 435 U.S. 734 (1978), this Court overruled Puget Sound Stevedoring Co. v. Tax Commissioner, 302 U.S. 90 (1937), and put to rest the direct-indirect test, reiterating the necessity to balance the burden placed on interstate commerce by the benefit to the state. This Court stated:

> "Respondents, therefore, have demonstrated no impediment imposed by the tax upon the regulation of foreign trade by the United States."
> 435 U.S. at 754.

In Moorman Manufacturing Co. v. Blair 437 U.S. 267 (1978), this Court pointed out that

states have wide latitude in the selection of appropriate formulas, which will be disturbed only in the event of clear evidence that the methods being used were unreasonable.[1/]

[1/] Moorman Manufacturing upheld a single factor formula applied by the state in attributing income taxes. The case emphasizes the broad ramifications which the instant case may have upon a wide spectrum of tax statutes.

California is one of the few states that requires U.S.-based and foreign-based multinational corporations to file a unitary or combined income tax return. Such requirements have had an increasingly adverse effect on the California business climate, and there is pending in the California Legislature Assembly Bill 525, which would eliminate such unitary or combined reporting for foreign-based multinationals. Domestic multinational corporations would not be affected. The rationale for such distinction is the more onerous burdens placed on foreign-based umltinationals by having to translate into U.S. accounting standards all their activites and in translating their world-wide incomes to U.S. currency.

In discussing the Zee Toys decision in testimony before the Assembly Revenue and Taxation Committee November 13, 1979, Ben Miller, counsel for the California Franchise Tax Board, stated:

(continued on p. 10)

In the instant case the court placed great reliance on Boston Stock Exchange v. State Tax Comm'r., 429 U.S. 318 (1977). The court, however, has misconstrued the Boston Stock Exchange case in stating that: "In that case, a state tax which discriminated against two types of interstate transactions was struck down." (Pet. Appendix p. 15.) The court overlooked that the vice in the Boston Stock Exchange case was the attempt by the State of New York to design a tax program which would provide a commercial advantage to local businesses (New York stock

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1/ (continued from previous page)

> "The California Appellate Court invalidated a state statute which exempted certain products shipped in foreign commerce from property taxation. The court held that the statute unconstitutionally discriminated in favor of foreign commerce, vis-a-vis interstate commerce. The court's reasoning might invalidate any efforts by the Legislature to place limitations on the application of the unitary concept based upon the geographic location of the operations.
>
> . . .
>
> "Based upon the court's holding [in Zee Toys], any attempt to limit the application of the unitary method, with respect to foreign-based businesses, would probably be constitutionally invalid." (Emphasis added.)

exchanges) to the detriment of out-of-state stock exchanges. This Court cautioned:

> "On various occasions when called upon to make the delicate adjustment between the national interest and free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case." (429 U.S. at 329.)

Under California's Free Port Law there is no distinction betwen out-of-state and in-state residents or businesses. Both are given the economic advantages of the Free Port Law, and any use by the court of a per se test was improper and misconstrued the Commerce Clause of the United States Constitution.

B. DISTINGUISHING BETWEEN GOODS BASED ON THEIR ORIGIN DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

The Court of Appeal based its holding on the following observation:

"Different tax treatment is, therefore, accorded to such goods solely on the basis of their place of origin. Foreign goods are thereby given a competitive advantage over interstate goods of the same nature and competing in the same market." (Pet. Appendix p. 11.)

There was no evidence of any competitive advantage. However, assuming for argument that there would be such a competitive advantage, it is submitted that this in and of itself does not violate the Commerce Clause, and that such distinctions are commonplace.

In Raley & Bros. v. Richardson, 264 U.S. 157 (1924), this Court upheld a Georgia tax upon brokers or commission merchanges dealing in intrastate goods, which tax was not imposed upon similar brokers dealing in goods originating in interstate commerce. This Court rejected arguments that such distinction violated the Commerce Clause. It is submitted that there is no distinction between the discrimination permitted in Raley & Bros. and the discrimination in the instant case. Neither places unreasonable burdens on interstate or foreign commerce, and neither violates the purposes of the Commerce Clause.

C. ZEE TOYS IS IN CONFLICT WITH OTHER STATE COURT DECISIONS WITH RESPECT TO THE CONSTITUTIONALITY OF FREE PORT LAWS.

All states encourage local industry by providing tax exemptions. Examples are domestic wines while aging in California, dairy products in Wisconsin, certain fish products in Louisiana, and wheat products in the Midwestern states. With increasing frequencies states have been providing exemptions to inventories, and especially inventories stored for transshipment. "Not only are inventories exempt in the few but very important states that exempt all personal property . . . but they are wholly or partially exempt if they have been brought into a state for storage or other limited activities before being shipped out of the state." (National Tax Journal, Property Tax Developments: Modernization, Classification, Site Value Taxation, 19:322, 324 (Sept. 1976).)

Such classification statutes are generally tested under Equal Protection principles. In the instant case the Court of Appeal conceded that if Los Angeles County were only invoking an Equal Protection argument, it could not prevail, since a rational basis existed for the distinction.

Over 35 states have some type of free port exemption. A substantial number of these statutes grant out-of-state or foreign products an exemption

which is denied to similar products manufactured or grown in the United States or in the state in question. These distinctions are based on the origin of the goods, the same distinction struck down in the instant case.

Amicus knows of no other instance in which a free port statute has been held unconstitutional.

In Appeal of Martin (S. Ct. N. C., 1974) 209 S. E. 2d 766, the court upheld a statute providing the following exemptions:

1. Cotton, tobacco, other farm products, goods, wares and merchandise held for shipment to any foreign country or stored at a seaport awaiting further shipment after being imported from a foreign country.

2. Personal property of nonresidents in their original package shipped into the state and placed in a public warehouse for the purpose of transshipment to a destination either outside of the state or within the state.

3. Personal property of residents in their original package placed in a public warehouse for transshipment, but only to an out-of-state destination. (G. S. §105-281 (1969)(Cum. Supp.)

The North Carolina statute discriminated based on the origin of the goods and based on the residence of the owner of the goods. The statute specifically described its purposes:

> "It is hereby declared to be the policy of this state to use its system of property taxation in such manner, through the classification of the aforementioned property, as to encourage the development of the ports of North Carolina . . . [and] to encourage the development of the State of North Carolina as a distribution center." (Emphasis added.)

Under the North Carolina statute a distributor, such as petitioner or either individual amicus, who warehouse in non-public facilities would: (a) be taxed on goods purchased domestically; (b) be given an exemption on imported goods. This is the same distinction struck down in the instant case.

In State Bd. of Tax Comm'rs. v. Carrier Corp. (S. Ct. Ind. 1977) 365 N. E. 2d 1385, ad valorem property tax exemptions were upheld under a statute almost identical to the one reviewed in The Appeal of Martin. In a petition for rehearing the court held that the statute did not unreasonably burden interstate commerce. (State Bd. of Tax Comm'rs. v. Carrier Corp. (S. Ct. Ind., 1977) 365 N. E. 2d 1153.)

If, in the instant case, the Court of Appeal has accurately interpreted Boston Stock Exchange and Michelin Tire Corp., then both the North Carolina and Indiana taxing schemes would also have to fail for violating the Commerce Clause.

In Nash Sales v. City of Milwaukee (S. Ct. Wisc., 1929) 224 N. W. 126, the State Legislature,

concerned about the competitive position of its warehousing industry, granted an exemption to property manufactured or produced outside of the state, and in storage in Wisconsin. The court held that there was no violation of the Commerce Clause, stating:

> "'The discretion of the Legislature in this field is so broad that it is not competent for the court to mark the constitutional limitations of it other than at the farthest one might go without transcending all reason.' [citation]" (at 129.)

In Allied Stores of Ohio v. Bowers, 358 U.S. 522, 3 L.Ed.2d 480, 79 S.Ct. 437 (1959), an Ohio statute exempted merchandise belonging to nonresidents held in storage but taxed similar property belonging to residents. This Court upheld the statute against Equal Protection arguments.

It is submitted that state classification statutes passed for the purpose of encouraging economic activity within the state do not violate the Commerce Clause merely by creating a distinction between types or classes of property. Only if the classification statute has as its purpose or effect favoring local business to the detriment of interstate or foreign businesses must a statute be tested under Commerce Clause statutes.

CONCLUSION

For the foregoing reasons the opinion of the Court of Appeal, Second Appellate District, should be reversed.

Respectfully submitted,

GERALD T. MANPEARL

Attorney for Petitioner

EVANS, MANPEARL & HARTER

and

KENT TEN BRINK

Of Counsel

APPENDIX A

COUNTY OF LOS ANGELES
OFFICE OF THE COUNTY COUNSEL
648 Hall of Administration
Los Angeles, California 90012

John H. Larson, County Counsel

October 10, 1979

Gerald T. Manpearl, Esq.
Evans, Manpearl & Harter
350 S. Figueroa Street
Suite 900
Los Angeles, California 90071

Re: Sears, Roebuck & Co. v. County of Los Angeles
No. 78-1577

Dear Mr. Manpearl:

This will confirm that we have no objection and consent to your filing an Amicus Curiae Brief on behalf of Sears, Roebuck & Co.

Yours truly,

JOHN E. LARSON
County Counsel

/s/ John Dexter Clark
By: JAMES DEXTER CLARK
Deputy County Counsel

APPENDIX B

Law Offices of
LOEB AND LOEB
One Wilshire Building
Sixteenth Floor
Wilshire Boulevard at Grand Avenue
Los Angeles, California 90017
(213) 629-0200 (213) 278-7351

October 10, 1979

Gerald T. Manpearl, Esq.
Evans, Manpearl & Harter
350 S. Figueroa Street
Suite 900
Los Angeles, California 90071

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/s/ Frank M. Keesling
Frank M. Keesling
of Loeb and Loeb